UNIVERSITY OF PENNSYLVANIA

# THE INSURANCE OF FOREIGN CREDITS

HARRY JAMES LOMAN

A THESIS

IN ECONOMICS

PRESENTED TO THE FACULTY OF THE GRADUATE SCHOOL OF THE UNIVERSITY OF PENNSYLVANIA IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF DOCTOR OF PHILOSOPHY

PHILADELPHIA

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# PREFACE

One of the most recent additions to the field of insurance is the assumption of the credit risk in export transactions. Thus far the business has not been developed on a very large scale but this can be explained by the lack of sufficient data on which to proceed, the complicated nature of the subject, and the absence of a uniform procedure among the several companies. However, the prospects for an extensive growth are very excellent after the pioneer work has been completed. Just as in the beginning of most types of insurance, underwriters in different localities have attempted simultaneously to assume the risk under widely divergent types of coverage. Although this may be the best for the business in the long run, it leads to misunderstandings and retards progress temporarily. An effort has been made in the present treatise to assemble and describe these various practices.

The plan of treatment used to accomplish this is an explanation of the financial risks attending export transactions, the methods which have been used thus far to absorb these risks, and the possibilities for development in the future.

In many cases the illustrations and explanations are not important because of their extensive or general use, but are given in order to indicate the desirability or undesirability of certain policy features and company practices.

While emphasis is placed on the needs of American exporters no attempt has been made to localize the practices or scope to the United States, especially since some English underwriters have had considerable valuable experience in this line.

The first chapter is devoted to definitions and the allocation of risk depending on the method of export. The second chapter analyzes the risk assumed by the various parties to an export transaction under the various methods of financing exports. Then follows the historical development of separate institutions for the express purpose of absorbing credit risk in foreign trade. This is followed by chapters on the types of credit insurance companies, the classification of the policies used, the analysis of the policies and the method of operation under the different

types, the making of rates and sources of information for this purpose, the settlement of losses under the different kinds of policies, and reinsurance.

The concluding chapter summarizes the advantages of foreign credit insurance and indicates the manner in which greater progress may be attained.

H. J. LOMAN.

UNIVERSITY OF PENNSYLVANIA,
June, 1923.

## Chapter I

# THE CREDIT RISK IN EXPORT TRADE

Every shipment of merchandise to a foreign buyer involves both transportation and credit hazards. The first relates to loss or damage due to fire, perils of the sea, pilferage and theft, and other similar causes. These have been for many years almost invariably transferred to fire and marine insurance companies. The second pertains to the risk that a buyer cannot or will not meet the terms of his contract, and it is only recently that insurance facilities have been available to assume this hazard.

**The credit risk defined.**—Ordinarily, the term "credit risk" includes any reason for which a foreign buyer fails to fulfill the terms of his contract. However, the expression really comprises two distinct hazards (1) the risk of insolvency or bankruptcy, and (2) the commercial risk.

1. *The risk of insolvency or bankruptcy.*—This consists of the failure of the buyer to pay because of inability arising out of insolvency or bankruptcy. Just what constitutes bankruptcy or insolvency depends on the laws of the country where the act is committed, and dictionary definitions are ofttimes of little value. Therefore, in order to make sure there will be no misunderstanding, it is customary for the policies to recite in detail all of the possible situations. The definition thus given may vary from "bankruptcy according to the law of the country" to "uncollectible at law." A more detailed discussion of these variations is reserved for a later chapter.

2. *The commercial risk.*—The commercial or mercantile risk pertains to the "refusal" of the buyer to pay. This is a much more inclusive term than the word signifies because it involves the moral hazards of rejection of merchandise and repudiation of the sales contract. Compare this, for instance, with the risk of insolvency or bankruptcy. If a merchant cannot settle his account because of lack of funds, he can usually supply satisfactory evidence that his statements are true. Furthermore,

he would not be apt to advertise his incapacity to pay if it were untrue, because of the resultant injury to his credit status in the business world. But, if he merely refuses to pay because of lack of desire, who can question his motives? He can advance a plausible reason for rejection or cancellation by claiming that the goods are inferior, or that the exporter has not fulfilled some of the terms of the agreement; and everybody but the seller might believe him. In fact, the whole proposition is so intangible that it is difficult for underwriters to predict the extent of loss caused in such a manner. Consequently, up to the present time, the problem of satisfactorily insuring the risk has not been solved, even though it is one that the exporters are quite anxious to have covered.

**The assumption of the credit risk.**—It has already been pointed out that, until recently, there were no insurance organizations to which any part of the credit risk could be transferred. Even now the availability of protection in a regular insurance company is limited, and part or all of the risk must frequently be absorbed in another manner. This does not mean that every producer of goods for export purposes must assume the credit risk; different available methods of exportation permit the shifting of this responsibility. A better understanding of the process of transferring this risk may be obtained through a brief explanation of the export methods now in use.

**Export methods.**—Two distinct methods of exporting are common in the United States, the first, direct, and the second, indirect.[1]

Direct exporting means that the producing seller seeks his own foreign buyers or foreign agents, makes direct contracts with them, arranges for the financing, attends to the shipping of the merchandise, and assumes the credit risk. Thus he has all of the advantages of direct contact with foreign buyers or foreign agents.

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[1] "Export Merchandising," Walter F. Wyman, McGraw-Hill Book Company, New York 1922.

Indirect exporting means there is a middleman between the original American seller and the foreign buyer. Several types of middlemen exist, of which the export commission houses are the most important. These organizations are theoretically the buying agents for foreign importers, in which capacity they charge them a commission for finding an American house from which the desired merchandise may be purchased. In order to operate, they maintain large organizations consisting of buying, shipping, insuring, and financing experts, as well as traveling salesmen. With these facilities, they are able to relieve the American seller of the burden of finding a market, attending to shipping problems, financing, and many other details. In addition, they usually guarantee the account and assume the credit risk. This is possible only because of their size and the wide distribution of sales.

Another type of middleman is the so-called export merchant. It is the business of the export merchant to buy and sell goods on his own account. Instead of making a profit by charging a commission, he makes the difference between the buying and selling price, less the expenses. Since he makes outright purchases from the American seller, he must assume all of the credit risk when he finds a foreign buyer.

A third middleman is the manufacturer's agent. The most important of several variations of this type of middleman is the agency which locates its offices in the territory it wishes to cover, obtaining exclusive rights if possible. A sales force is maintained and the agency receives a commission for the orders obtained. In return for this it not only attends to the delivery of the goods, but also assumes the credit risk. Another type of manufacturer's agent travels around soliciting orders from commission houses for the account of the manufacturer and the credit risk is assumed by the commission house.

In the past, the middlemen have been the dominant factors in the export trade of the United States, but there is a tendency for direct exporting to attain greater importance. This tendency has become more pronounced as manufactures have assumed an increasing proportion of the total exporting and may be explained

by the greater desirability of direct contact in the case of competitive, manufactured articles than in the case of raw materials and food products. Nevertheless, there has been at least one deterrent effect in this change to direct exporting, and that is the assumption of the credit risk. One of the purposes of this treatise is to examine the extent to which this responsibility may be transferred.

## Chapter II

# ANALYSIS OF THE EXTENT OF THE RISK ASSUMED UNDER THE VARIOUS METHODS OF FINANCING EXPORTS

**Variation in the extent of the risk assumed by the exporter.**—The exact extent of the risk assumed or transferred by the different types of exporters explained in the previous chapter depends on the terms of payment. Possibly the clearest way to portray the degree of this risk is by an examination of the different terms of payment which are used. Such a presentation will also serve another purpose, namely, that of indicating the various situations which may be the bases for different insurance policies. In order to accomplish these ends, it does not seem necessary to explain all of the variations of the different terms of payment and the classification which follows pertains only to the major divisions. These are arranged with a view to emphasizing the insurance protection which is needed.

**Principal terms of payment used in foreign trade.**[1]—The principal terms of payment used in foreign trade are: (1) cash with order; (2) documents against payment; (3) documents against acceptance, and (4) open account.

1. Cash with order: Sometimes the importer is required to send cash before the exporter will fill his order. This may be due to a number of reasons, such as previous unsatisfactory ledger experience with the customer, lack of data on his credit standing, adverse credit information, or because the exporter possesses a monopoly of his product. The last mentioned possibly covers most of the cases where the method just described is used. Obviously, where this situation prevails, no credit insurance is necessary because no credit has been granted and the

[1] "Problems in Export Sales Management," Harry R. Tosdal, A. W. Shaw Company, Chicago, 1922, p. 458.

purchaser has done his own financing. However, competition requires the granting of more liberal terms, and financing on a cash basis is a very small percentage of the total exports.

2. Documents against payment: This means that the documents conveying title to the merchandise will not be surrendered until payment is made. Provision for payment in such cases is frequently made by means of a letter of credit, which will be described later.

In any event, even under the terms "documents against payment" the exporter may suffer loss because he usually incurs expense before the documents can be presented, whether it be documents against payment at port of shipment or port of entry. However, it is the latter that involves the greatest risk, and this is true even though the importer does not get the goods until the demand or sight draft has been paid, because if he elects not to "take up" the documents and pay for the goods, the exporter may lose heavily. The experience which American exporters had in 1920, when goods financed in this manner were refused at ports of entry and orders cancelled, is an excellent illustration. The exporters had incurred much expense in these cases and resale resulted in large losses. It is this resale loss, where the cause of rejection is not the exporter's fault, against which some kind of protection is needed, although it is very debatable whether such risk is a desirable subject for insurance because of the moral hazard connected with the refusal of merchandise. Nevertheless, it seems possible to issue insurance policies which will protect the insured against loss regardless of cause, as long as he is not at fault.[2] The insurance of the payment of the draft is the protection actually needed to cover the contingencies of the situation.

3. Documents against acceptance: In this case the title to goods will be transferred only when the draft is accepted by the consignee, or a bank if a letter of credit has been established. If it is drawn direct on the consignee, he will not obtain the documents entitling him to the shipment until the draft has been accepted. This differs from method number 2 in that he

[2] *Ibid.*, see p. 94.

"accepts" the draft in order to get the documents, instead of paying the bill. When the customer has accepted such instrument it will seriously impair his standing if there is a default, and consequently, there is not as dangerous a risk as where his signature does not appear on a negotiable instrument. However, his insolvency between the date of acceptance and the date of payment is one of the contingencies which requires insurance protection. The possibility of insolvency naturally is greater the longer this period happens to be. Therefore, for insurance purposes, drafts will have to be divided in accordance with the length of time for which they run, and this gives rise to many subdivisions, the principal ones of which are 30, 60, 90, 120, 150, and 180 days. The days referred to may be applied to ordinary "time drafts," *i. e.*, number of days from date of making; or to "time sight drafts," *i. e.*, number of days from date of acceptance. It follows, then, that the protection will have to be varied according to time drafts and time sight drafts, and then further divided according to the duration of the draft.

The preceding remarks for the major part have dealt with trade credits, but in general might also be applied to bank credits. This usually means that the bank "accepts" the draft according to the terms of the letter of credit which has been established. However, the bank may have accepted considerable responsibility concerning the condition of the documents when presented and may be assuming both insolvency and commercial risk.

4. Open account: The last set of terms upon which a good many transactions are made is the open account. This merely means that the exporter will deliver the goods to the importer without requiring any written financial obligation from the importer until some later date. It is customary in such cases to offer the importer discounts for cash, varying with the period for which payment is withheld.

**Commercial letters of credit.**[3]—Frequently the exporter does not depend to an unlimited extent on the importer for payment, but tries to get a bank to assume the responsibility. This is usually accomplished by means of a commercial letter of credit, which may be used in connection with "documents against payment" or "documents against acceptance." The procedure under a commercial letter of credit usually takes the following form:[4] "A," an exporter, wants to be sure that "B," an importer, will make payment for his shipment, so he tells "B" he must furnish a letter of credit so that he can draw the drafts on a bank instead of "B." "B" then goes to his bank "X" and asks it to honor drafts drawn on it by "A" and charge the sum against his ("B's") account. The bank, knowing "B" and possibly carrying his account, is willing to do this, but "A" does not wish to draw on "B's" bank and wait for payment, so "B's" bank makes arrangements with bank "Y" in the exporter's country to honor the drafts which "A" draws on "B's" bank. "A" is then notified of the bank where such arrangements have been made, and consequently, presents his drafts to this bank which discounts them promptly.

**Kinds of letters of credit.**—Not all of these so-called letters of credit are of equal value, because the liability of the banks to honor the drafts may be limited. In general they fall into three classes:[5] (1) Where the letter of credit is revocable by the issuer and not confirmed by the advising bank. (2) Where it is irrevocable by the issuer but not confirmed by the adviser. (3) Where it is irrevocable by the issuer and has been confirmed by the adviser.

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[3] The principal sources of this information are:
"Commercial Credit Instruments and Practice in Financing Foreign Trade," George W. Edwards, American Acceptance Council, New York, 1922.
"Foreign Commercial Credits," George W. Edwards, McGraw-Hill Book Company, New York, 1922.
"Commercial Paper," W. H. Kniffin, Jr., The Bankers' Publishing Company, New York, 1920.
"Acceptances, Trade and Bankers," Park Mathewson, D. Appleton & Company, New York, 1921.

[4] "Foreign Commercial Credits," George W. Edwards, McGraw-Hill Book Company, New York, 1922, pp. 35–44.

[5] *Ibid,*

1. Revocable by the issuer and not confirmed by the advising bank: If this is the kind of credit which "B" succeeds in establishing in favor of "A," it means that bank "X" has issued a letter authorizing bank "Y" to accept drafts drawn by "A" up to a certain amount. If this is done in the manner prescribed, bank "X" will be responsible. Bank "Y" then notifies "A" of the credit which has been established. However, the letter of credit states that it is cancellable at any time prior to negotiation of drafts drawn by "A," and since "Y" has not "confirmed" it, no guarantee exists so far as "Y" is concerned. Therefore, it behooves "A" to draw his drafts before anything goes amiss with the letter of credit.

2. Irrevocable by the issuer but not confirmed by the adviser: This is like the preceding case, except that bank "X" does not have the privilege of cancelling, prior to the expiration date specified in the letter of credit, unless "A," the beneficiary, gives his consent.

3. Irrevocable by the issuer and confirmed by the adviser: This type of letter is the same as number 2 as far as the issuing bank "X" is concerned. However, it is reinforced by the confirmation of the advising bank "Y." In this case the drafts will most likely be drawn directly on "Y."

Naturally, the credit that is most satisfactory and most used is the last because the responsibility has been more effectively shifted to the bank and cannot be withdrawn without the consent of the exporter within the time limits and conditions of the letter. Ordinarily, the protection under such letters does not contemplate the commercial risk involving rejection, disputes as to quality, etc. It should be observed, however, that letters of credit lack standardization, and in some cases, the banks in accepting documentary bills assume a responsibility for investigating certain things pertaining to the shipment that virtually amounts to assumption of a portion of the commercial risk. It might be mentioned that this should not be the regular function of a bank and is highly undesirable.

**Kinds of drafts.**—The reason for assuming the responsibility of some of the commercial risk may be more clearly understood

if the types of bills that are accepted under letters of credit are indicated. They may be divided into two groups: (1) Clean. (2) Documentary.

A "clean bill" derives its name from the fact that it is presented by itself without any accompanying documents, while a "documentary bill" has the insurance certificate, the bill of lading, and other export documents attached. Although the second involves more work on the part of the bank in checking over the documents to see that they are satisfactory, it gives more certain security, because the bank, through the documents, has complete control of the goods. The bank can upon their arrival, release goods under the terms of a trust receipt which acknowledges it to be the owner. Thus it has assumed comparatively little actual risk and has made the transaction possible.

**Defects of letters of credit.**—Some bankers have even gone so far as to say that, since this method is available, there is no need for foreign credit insurance. They fail to realize that the importer is really financing himself, that the exporter is not always relieved of liability, and that the practice involves two elements of cost: (1) time in arranging credit, and (2) the charge of the banks. From the description given above it can be seen that considerable time is necessary to arrange a complete credit, and in the meantime, the prospective order slips away from the exporter. Furthermore, it is maintained that the importer's local bank cannot alone handle the transaction because the exporter wants a bank in his country to accept the drafts in order to make cash available immediately. As a result, at least two banks are involved, unless the importer's bank maintains a branch close to the exporter (incidentally a big advantage of branch banks) and both must make some profit out of it. In the final analysis, this profit is added to the cost of the goods and makes competition with the exporters of other nations more difficult. Some bankers say that the way to eliminate this difficulty is to refund to the importer the cost of the letter of credit but this only means that the exporter will make his original quotation high enough to permit of such re-

duction. It might be added that when such an operation as the one just described takes place it really cannot be considered a credit transaction from the standpoint of the exporter because he has not extended credit to anyone, but merely delivered goods to someone whom the banks have financed.

Even where this method is possible, the desirability of credit insurance is not absent. It was mentioned above that the exporter is not always relieved of complete liability even if the credit is irrevocable. In the first place, the irrevocable letter of credit may be cancelled if the documents are not entirely in accord with the terms of the credit or if not presented within the allotted time. Secondly, if a negotiating bank has discounted in good faith and the drawee fails to pay, the drawer is liable, *i. e.*, the negotiating bank has recourse against the drawee and can demand the return of the amount advanced. Many exporters are not aware of this latter point but the Negotiable Instruments Law gives a bona fide holder of a bill the right of recourse against the drawer if the drawee defaults.

**Credit versus lack of credit.**—It may be concluded from the foregoing that the two most important cases where insurance protection is needed are under the open account, and where documents are surrendered against the acceptance of the importer. Not only are these the two cases which need insurance protection, but they are the two most natural ways to finance a transaction. Some deny that they are the proper ways to finance exports but admit that they do well enough in domestic transactions. If this is true, why are they inapplicable to exporting? The answer is that exporters are not so well informed on the credit standing of foreign buyers. That is just exactly the problem which insurance of foreign credits should solve. It might be mentioned at this point that there are some very prominent bankers who claim the only way to export is by means of an irrevocable letter of credit. However, these bankers must remember that this is not the way our foreign competitors do business, and we will have to meet their terms if we wish to be successful.[6] Also it should be remarked that cash with order

[6] "Problems in Export Sales Management," Harry R. Tosdal, A. W. Shaw Company, Chicago 1922, p. 459.

and irrevocable letters of credit are not extensions of credit at all. Perhaps it is best to let the men in the export business decide the question. The writer happened to attend the group session on Foreign Credits at the annual convention of the National Foreign Trade Council in 1922 where this question was raised and discussed. The chairman of the meeting called for a vote on it and the group was emphatically of the opinion that credit extension was necessary in foreign trade, and that cash with order and irrevocable letters of credit did not amount to credit extensions.

**Ability of the banks to extend credit and distribute the risk.**—Several years ago there was much agitation concerning the lack of export financing facilities in the United States. This led to the passage of amendments to the Federal Reserve Act and to other voluntary reforms in banking methods which would meet the demand. The most important aids to financing introduced were: (1) branch banking; (2) the inauguration of the Acceptance Syndicate Plan; (3) Edge Act financing, and (4) advances from the War Finance Corporation. A brief analysis of the work of each of these in aiding export financing is given below.

1. Branch banks: Branch banks are of two types, (1) the branches of foreign banking corporations organized under state laws, and (2) branches of national banks operating under the provisions of an amendment to the Federal Reserve Act.[7] These branches are a great aid to export, as well as import financing, because the banks can make direct arrangements for credit, do all their own collecting of drafts, and gather credit data. The latter function is one of the most important accomplishments made possible by this system. The branch banks are located in the important trade centers and they gather their information first hand. It is the data thus collected that enable them safely to assume the risks of granting credit. However, the main point must not be lost sight of, namely, that these banks merely aid in foreign trade by making the financing possible and do not guarantee credits.

[7] See "Foreign Branch Banking" in the Sixth, Seventh and Eighth Annual Reports of the Federal Reserve Board.

2. Acceptance Syndicate Plan for financing exports:[8] During the war the United States took over a lot of the financing of foreign trade that formerly was done by England, so that "sterling credits" have been largely displaced by "dollar credits." The United States, however, did not have their financing facilities developed to the point where they could accommodate the cases calling for very large sums. Consequently, when a bank was asked to finance a large shipment, it was necessary to get other banks to participate. This led to the so-called Acceptance Syndicate Plan which has since been extensively used in distributing the burden of financing our exports. Under this plan many banks associated by ties of one kind or another divide among themselves the various large advances which their customers need. If, for illustration, an exporter goes to his bank and asks it to finance a large shipment, and it is unable to do so itself, it may, nevertheless, accept his business. Then it will proceed to associate other banks with it in the venture, and each will assume a portion. The bank which was first approached by the exporter usually acts as the manager of this so-called syndicate, and attends to all the direct transacting of the business. However, it does not assume all the responsibility, but proceeds either to see that there are separate agreements between the exporter and each bank aiding in the advance, or to draw upon these banks for acceptance. The syndicate manager also attends to collecting the debt as well as registering it, passing on the documents, etc. Later, if the accepting bank does not dispose of them, the accepted drafts may be returned to the manager for sale in the open market. This is only an accommodation on the part of the syndicate manager, as he is not obligated to find a market for the drafts. For the extra work involved, the syndicate manager generally receives some compensation either in the form of a difference in the discount rate paid by the exporter and received by the other members of the syndicate; or a direct compensation paid by the exporter to the syndicate manager.

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[8] Acceptance Syndicate Plan for Financing Exports, J. T. Holdsworth, the Bank of Pittsburgh, N. A., 1921.

The plan is being rather extensively used among the banks interested in foreign trade, including the "Edge" banks. The principle involved in this method is fundamental in the field of insurance, namely, distribution of the burden. It is this wide distribution of risk and the source of credit supply that enables the financing of large undertakings for long periods of time. Although the expression "risk" is used, the amount of risk assumed is comparatively small except in so far as the manager of the syndicate may make errors in passing upon the documents.

3. Edge Act financing: The limitations placed on branch banks because of their connections with the national banks led to a demand for a type of bank which would not be subject to the existing restrictions.

The demand was satisfied by the passage of the Edge Act,[9] which became effective December, 1919, when the Federal Government made provision for the creation of special banks for the purpose of financing exports and imports. This amendment to the Federal Reserve Act provides that the banks incorporated under it are to be subject to the supervision of the Federal Reserve Board. These banks may be of two general types, one known as the acceptance bank, and the other as the debenture bond-issuing type.[10] The former is the more important just now and the three banks created so far under the Edge Act are of the "acceptance type." A brief description of their method of operation follows:

When an exporter desires to have a shipment financed through one of the so-called "Edge" banks, he presents his proposition to the bank selected.[11] Before the bank will finance him, it is necessary for it to make a careful investigation of his credit

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[9] Section 25a, the Federal Reserve Act.

[10] At the time the "Edge Act" was passed it was thought that the bond issuing type of bank was the most important. According to the Act the bank would satisfy itself of the credit standing of foreign importers to the extent of requiring deposits of collateral; discount drafts drawn against such importers and use these drafts as collateral against which bonds would be issued to any willing buyer. The financing would thus be passed on to the public but the credit problem would be unsolved since the importer really furnishes the credit. No bank of this type has yet been established.

[11] "Edge Law Banking," the First Federal Foreign Banking Association, New York, 1921.
"Acceptance Financing and the International Acceptance Bank," James P. Warburg, International Acceptance Bank, Inc., New York, 1923.

responsibility and financial condition. The bank does not make a practice of accepting export bills indiscriminately but makes a careful inquiry into the status of the exporters whom it finances. If, after careful investigation, the case is deserving, the bank notifies the exporter that it is willing to do business with him. He is informed of the amount of bills that it will discount for him at any one time. It is then necessary for him to make an agreement with the bank so that it will be adequately protected on the drafts that are drawn, because the usual practice is to take care of secured acceptance credits only, although in exceptional cases unsecured acceptance credits will be financed under the law regulating acceptances.

The agreement that is ordinarily made between the bank and the exporter in the case of secured credits provides that the exporter must be responsible for seeing that the bank has the necessary sum in its hands one day before maturity of the various acceptances which it has financed.[12] The exporter agrees not to hold the bank responsible in case of any risk or error in telegrams, cablegrams, letters or other means of communication, or any letters or documents pertaining to the drafts. If the exporter should suspend operations, or make any assignment for the benefit of creditors, or if a bankruptcy petition be filed against him, or if he fail to fulfill any obligation under the agreement, the amount of the draft immediately becomes due from him. The bank is given the right to take any action it sees fit in the collection of any or all of the outstanding drafts, and the exporter agrees to indemnify the bank fully for any loss sustained by such action. An agreement of this nature is signed the first time that an exporter has any dealings with a bank and is considered to apply to all future transactions. The exporter is now in a position where the bank is willing to give aid. He then sends to the bank all of the documents pertaining to the shipment that he desires financed, and draws a clean draft on the bank itself. The acceptance agreement has transferred the title of these documents to the bank, and the bank now proceeds to collect them and accepts the clean draft drawn by the

[12] From a typical "Acceptance Agreement."

exporter upon it. These documents and the draft are regarded as collateral security for the clean draft drawn by the exporter on the bank and which the bank has accepted. This clean draft is considered as prime commercial paper, and is readily sold in the open discount market. It is ordinarily marketed through the banks with the aid of the various discount houses.[13] A more favorable rate is enjoyed than on ordinary paper because of the bank's name upon it.

Since such paper is eligible for rediscount, the Federal Reserve Banks, as well as the commercial banks, savings banks, private corporations, and individuals purchase it. When a draft is sold the exporter receives his money, and since the sale is usually accomplished in a very short space of time, the exporter can use his funds for other purposes. It should be mentioned that he has the additional advantage in such cases, of not carrying any deposit with an "Edge" bank and thus the entire sum is released for his use.

While this method is very advantageous in that these banks can finance the secured acceptances up to very large amounts, not being subject to the 10-per-cent limitation, it nevertheless, has the main deficiency that practically all other methods of financing possess, *i. e.*, there is no guarantee that the exporter will not have to return this advance because of the default of the drawee. It will be observed that under the terms of the acceptance, the exporter agrees to hold the bank harmless. This means that the bank is merely advancing money and performing a collection service, but the exporter has no assurance that he will not be called upon at some later date to indemnify the bank because the importer failed in one way or another to fulfill his contract. In other words, the credit is extended on the name of the seller and the status of the buyer is relatively unimportant.

4. The War Finance Corporation[14]: The War Finance Cor-

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[13] Pamphlet published by the First Federal Foreign Banking Association, New York, 1923.

[14] First, Second, Third and Fourth Annual Reports of the War Finance Corporation.

poration was originally created by an act of Congress approved April 5, 1918, for the purpose of extending assistance to industries "necessary or contributory to the prosecution of the war" by making advances under restricted conditions to banks, bankers, and trust companies that had tendered financial assistance to such industries, and in exceptional cases, to the industries direct.

An act approved March 31, 1919, amended the original act so that the corporation was authorized to make advances to assist in the exportation of domestic products to foreign countries. This amendment was passed so that exporters could finance long-term credits and was brought about by fear of a big decline of foreign trade with the resulting disruption of internal business. However, it was not until December 29, 1919, that the first loan was made under the amended act. Its opera- operations were destined to be short-lived because on May 10, 1920, at the request of the Secretary of the Treasury, advances in aid of exports were suspended. In his letter to the Board of Directors of the War Finance Corporation the Secretary of the Treasury pointed out that the corporation was supposed automatically to cease operations six months after actual termination of the war, and that the long-continued technical state of war had not been contemplated when the act and its amendments were passed. He said that the need for such a corporation to finance war industries no longer existed, and that private interests were capable of financing exports. Furthermore, financing by the War Finance Corporation tied up treasury funds that were needed, and he requested that all further advances cease, whereupon the Board of Directors voted to suspend operations.

In response to an overwhelming demand, Congress, on January 4, 1921, by a joint resolution ordered the War Finance Corporation to resume operations. At this time the powers of the corporation were restricted to financing exports, but these were subsequently enlarged by the Agricultural Credits Act of August, 1921. The figures show that the facilities of the corporation for aiding exports have not been used to a very great extent since resumption of activities. However, this is easily explained because it is provided that all advances are to "be made against

a promissory note or notes, or other instrument or instruments in writing, imposing on the borrower a primary and unconditional obligation to repay the advance at maturity, with interest as stipulated therein, with full and adequate security in each instance by indorsement, guaranty, pledge, or otherwise. The corporation shall retain the power to require additional security at any time. All notes or other instruments evidencing advances to persons outside of the United States shall be in terms payable in the United States, in currency of the United States, and shall be secured by adequate guaranties or indorsements in the United States, or by warehouse receipts, acceptable collateral, or other instruments in writing conveying or securing marketable title to agricultural products in the United States."[15]

**Conclusion.**—Unquestionably all of these methods of financing which have been inaugurated recently are big improvements over former methods. Advances that were impossible are now quite easily obtained. However, these advances nearly always take the form of discounting with the right of recourse. In other words, the exporter usually has no guarantee that he is freed from all liability in the future. The extent of the liability thus assumed by the exporter under the various methods of financing, except cash, may be summarized as follows:

1. Documents against payment: In this case the buyer must pay before he obtains the merchandise. Therefore, the risk that the exporter runs is the failure of the buyer to take up the documents. Regardless of the reason for this default, the exporter retains control of the merchandise and the most he can lose is the difference between the contract price and the net proceeds of a resale, which means that he stands to lose the difference between his contract price and resale price.

2. Documents against acceptance: This differs from documents against payment in that after the buyer "accepts," the goods are virtually out of the control of the seller and the failure of the buyer to pay the note when due may cause the

[15] Section 23, the War Finance Corporation Act, amended.

seller to lose the full amount. Of course, the danger is reduced if a letter of credit has been used and a bank has assumed the responsibility.

3. Open account: In this method the seller assumes a 100-per-cent risk that the buyer will live up to the terms of the contract. It should be distinguished from the preceding cases in that the buyer has not placed his signature on a negotiable instrument.

## Chapter III

# THE HISTORICAL DEVELOPMENT OF FOREIGN CREDIT INSURANCE[1]

Realization of the inadequacies of the banks in assuming the risk of credit loss has led to the development of a separate institution for the purpose. Although the first foreign credit insurance policy was probably written by one of Lloyd's underwriters over thirty years ago, and was confined to the insurance of commercial bills of exchange, the idea of guaranteeing debts goes back to the time of the South Sea Bubble. Undoubtedly the need for protection against other persons' dishonesty and misfortune has existed from the beginning of credit transactions and for over a century the principles of a mutual pooling or sharing of credits have been practiced. Pooling was confined to trades where merchants found it necessary to combine their resources in order successfully to consummate some kind of commercial venture. Within the past thirty years some English banks and trust companies have promoted schemes for guaranteeing the payment of bills of exchange, but such schemes made no discrimination between trade and accommodation paper and after a brief trial were abandoned as unsatisfactory.[2]

**Early developments in Germany.**[3]—It is claimed that the Germans were the first to recognize the importance of solving the credit problem in foreign trade and their development in this line began many years ago. However, it was the German banks and not the insurance companies which were the pioneers in assuming the credit risk.

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[1] Chronological order is followed.

[2] The foregoing is adapted from a pamphlet on Credit Insurance, by H. Stanley Spain, Insurance Publishing Company, Ltd., London, 1922.

[3] Germany's Commercial Grip on the World," Henri Hauser, Charles Scribner's Sons, New York, 1917, and "How Germany Does Business," Paul Pensac Gourvitch, B. W. Huebsch, New York, 1917.

It has been aptly stated that the medley of functions of a bank in Germany, where the institution is a deposit bank, a credit bank, and a financing company at one and the same time, is enough to make the hair of the ordinary bankers stand on end. Discounting without recourse was a common and increasing practice prior to the war with these so-called "del credere" institutions. This was made possible by the credit data on the foreign buyers which they were able to obtain. Such information was available through two main sources: (1) The branch banks, and (2) the "Schimmelpfeng Information Company." The former had the advantage of an early start, as Germany began branch banking on a small scale in 1869 and from 1894 on, the expansion of such banks was very rapid. The "Schimmelpfeng Information Company" maintained branches in all parts of the world and was able to supply the bankers with much valuable information. In fact, it was claimed to be one of the most important factors in the development of Germany's international banking facilities.

There were other factors, however, that aided in the success of the German plan. In the first place, the German system of exporting to many small risks made possible a very wide distribution as to buyers and countries. Secondly, credit was granted judiciously. The statement is often made that Germany's long-term credits in foreign trade were the cause of their success. Investigation reveals that their credits were ordinarily ninety days, but they were always willing to give long credit where the situation required. They did not base conclusions on the request of the importer, but on first-hand information showing the necessity for liberal terms. This does not mean that they never granted speculative credit terms; they did in Japan, much to their regret. In fact, their experiences in that country taught them that credit should be automatic, and that terms longer than those necessary to liquidate the debt enable the importer to overbuy with disastrous results.

Nevertheless, the general success of the German bankers in discounting without recourse should not be an inducement to American bankers to do the same because it means that the bank must go in the insurance business. While banking and

insurance are closely associated, they should be kept separate and distinct from each other, since insurance is based on the assumption of risk while banking should proceed on the theory of all risk being eliminated.

**Early attempts at foreign credit insurance in the United States.**—Possibly the first organized attempt in the United States to insure foreign credits was made by an export commission house some twenty-odd years ago. The manager of this house had compiled considerable credit information on foreign buyers and thought that, with this as a basis, it would be possible to insure credit extensions. The attempt, however, was not very successful and the business was transferred to another party interested in insurance, who failed to push the matter, and it shortly passed out of existence. With the exception of the efforts of some merchants to get the banks to discount without the right of recourse, no further attempts were made for a general plan until within the last five years.

**Recent interest in foreign credit insurance.**—Immediately following the war, the subject of credit insurance seemed to be one of the uppermost thoughts in the minds of those who were interested in foreign trade. This interest was the result of war conditions, namely, the deterioration or destruction of the credit structure of many nations. Logically then, one can expect to find the greatest efforts at the restoration of this credit on the part of those nations most vitally affected by foreign commerce, which may explain why the activities of England and the United States along credit insurance lines are particularly noteworthy.

In England much of the effort has come from the government,[4] and real attempts to insure have had governmental sanction. As a matter of fact, the government has actively participated in such schemes to the extent of passing several laws under the terms of which it assumes a great deal of risk connected with

[4] W. S. Hollis, "British Insurance Against Bad Debts Abroad," *Commerce Reports, Bureau of Foreign and Domestic Commerce, United States Department of Commerce*, No. 231, October 2, 1919, pp. 18–21.

export financing.[5] However, in the United States most of the efforts have been on the part of private interests. At least this is true in so far as the assumption of risk is concerned. The Federal Government has confined its assistance to the passage of legislation which will aid the financing machinery and increase banking facilities, but usually no risk has been assumed under any of the methods.

**The American Manufacturers' Foreign Credit Insurance Exchange.**—Before the World War was actually ended, the Illinois Manufacturers' Association had become actively interested in a plan for foreign credit insurance. Mr. George R. Meyercord, President of the Illinois Manufacturers' Association at that time, and also President of the Meyercord Company of Chicago, proposed at the National Foreign Trade Council Convention at Cincinnati, in 1918, a plan for insuring the credits of small direct exporters. His statements were the result of an investigation by the Foreign Trade Committee of the Illinois Manufacturers' Association, and it was the first really tangible plan ever seriously considered. The National Foreign Trade Council in a group session commented on Mr. Meyercord's proposal and urged that the Illinois Manufacturers' Association push the proposition. As a result, after about three years of careful study, between $250,000 and $300,000 was advanced by Mr. Meyercord and his associates for the purpose of getting the necessary information on which to base rates and to establish a reciprocal mutual for the insuring of foreign credits. This company has enjoyed a very rapid growth. Starting with the insuring of about 100 members' accounts in February, 1921, it increased to 400 members in one year and has continued to grow until at the present time (1923) it has over 600 members, including some of the largest exporters in the country. It is unquestionably the most successful effort of the kind and has received the sanction of the English Underwriters.

Not only does this company insure credits, but it also gathers

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[5] Wilbur J. Page, "The British Government's Revised Export Credit Plan," *Commerce Reports, Bureau of Foreign and Domestic Commerce, United States Department of Commerce*, August 2, 1921.

the necessary information in order to establish rates and safely accept risks. As previously noted, it is a reciprocal mutual, this type of organization having been adopted, according to its President, solely because it was necessary to have a common exchange of ledger experience by the different members, as otherwise there would have been no sound method of predicating rates. Other functions performed by this organization are to furnish market guides, or what may be called credit rating books, which are similar to Dun's and Bradstreet's rating books used in domestic commerce, and to eliminate both the dishonest sellers and dishonest buyers in foreign trade. To accomplish this latter result a rather ingenious system has been devised whereby the insurance exchange is able to keep a continuous check on each of the foreign shipments made by its members.

The function of this exchange in compiling credit information and issuing it in the form of credit guides will be discussed in connection with "Sources of Credit Information." Its most important function, that of insuring credit risks, need be referred to but briefly at this point because the type of policy and the operations necessary to the handling of this policy are also given in later chapters. Suffice it to say that the only coverage given is that which protects against insolvency, and the method of insuring is by unit shipments, certificates of insurance being issued for each risk that is acceptable under the terms of an open-master policy.

**Other proposed American plans.**—About the same time that Mr. Meyercord inaugurated his campaign, Mr. Helburn, of the American Tanners' Council, suggested a plan for the insurance of foreign credits.[6] His proposal was that a number of the exporters should form a Mutual Insurance Company and combine the credit information of all, and on this basis decide the rates and issue the proper policies. Each member was to estimate his foreign sales and pay an advance premium based on the year's estimate. Each time that a shipment was

[6] J. W. Helburn, "Plan for a Mutual Insurance Association for the Insurance of Foreign Trade Credits," *Economic World* (new series), Vol. 18, August 2, 1919, pp. 165–166.

made, he was to obtain a certificate of insurance from the Central Office, or a notification that the risk was uninsurable. It was pointed out that the exports of the members of the Tanners' Council ran from $60,000,000 to $120,000,000 per year, and it was estimated that the total cost of insurance on this would not exceed 1 per cent, if the different members of the proposed insurance company would pool their ledger experience and credit files so they could use them as the basis for insurance. However, in order to start operations, it was necessary to obtain considerable working capital, and since nobody cared to advance the necessary funds, definite action on this specific proposal was not taken. But the reluctance may be attributed largely to the fact that in the meantime the members approved the plan of the American Manufacturers' Foreign Credit Insurance Exchange.

In 1919, one of the large bonding companies became interested in the insurance of foreign credits, but owing to the lack of credit information no favorable action was taken.

**The plan of the British Government.**—In September, 1919, the British Government passed a bill for the purpose of aiding exports.[7] Provision was made for the advancing of 80 per cent of the cost of the goods exported to certain approved countries. At the time of the passage of the bill it was intended that there should be a guarantee of payment included. However, the interpretation placed upon the law was to the effect that the government had no power to guarantee. Because of this obstacle and the objections that were raised to an 80-per-cent advance, a revised export credit plan was enacted in June, 1921.[8] This scheme provides for the guarantee of credits direct to individual exporters or for the acceptance of a share of losses incurred by banks, credit associations, and like organizations.

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[7] W. S. Hollis, "British Insurance Against Bad Debts Abroad," *Commerce Reports, Bureau of Foreign and Domestic Commerce, United States Department of Commerce*, No. 231, October 2, 1919, pp. 18–21.

[8] Wilbur J. Page, "The British Government's Revised Export Credit Plan," Commerce Reports, Bureau of Foreign and Domestic Commerce, United States Department of Commerce, August 2, 1921.

The method of operation is through an Export Credit Department maintained by the Government, which passes upon all of the drafts presented, and the securities deposited for their protection. The maximum amount that will be advanced is 85 per cent of the total amount of the bill drawn against the shipment. The Export Credit Department decides each case individually and the proportion which it will accept depends on the market values, net profit, and security. Under the first export credit plan it was necessary for the importer to deposit security to the extent of 100 per cent or more of the amount of the draft. Even in these cases, the government did not advance money without the right of recourse. Under the revised plan, however, the government is willing to guarantee a portion of the draft without the right of recourse. The amount of recourse retained by the government against the exporter is intended to be 50 per cent. It is therefore provided that the government retain recourse against the exporter for half the loss after the deduction of the amount realized by the exporter on any security or any money paid to him by the importer.

The main idea of both of these plans is to aid in the restoration of the natural flow of commerce between Great Britain and its different colonies and protectorates, war conditions having badly disrupted the trade between Britain and these territories. Therefore, these plans cannot be considered as international schemes, but as being mainly intended to help solve some of Great Britain's colonial foreign trade difficulties arising out of the war.

**The Trade Indemnity Company.**—Shortly after the formation of the British Trade Corporation, it was decided that the corporation should have a subsidiary to take care of the insurance of foreign credits. For this purpose a separate corporation was organized under the name of the Trade Indemnity Company, Limited, with an authorized capital of £100,000. The Trade Indemnity Company was consolidated with the Excess Insurance Company, which had taken care of domestic credit insurance for a number of years on its own account. The experience of the Excess Insurance Company in England's domestic credit insur-

ance served as a basis for the operations of the new company, which did not, however, immediately branch out and take risks all over the world. A great variety of policies have been issued in order to meet the situations arising in different kinds of trades, but there is nothing unique in any of the plans adopted. In most cases the liability of the insurance company is fractional, and insolvency is the only event insured against.

**The Associated Exporters' Foreign Credit Guarantee Exchange.**—About the middle of the year 1922, a reciprocal mutual known as the Associated Exporters' Foreign Credit Guarantee Exchange began business by writing a policy which covered not only losses due to insolvency but also guaranteed the integrity of the sales contract. This means that the risk of repudiation of the contract and rejection of goods was assumed. The moral hazard involved in such cases would seem to be almost incalculable and many insurance underwriters have maintained that the risk is uninsurable. Nevertheless, this company wrote business for several months at a very moderate rate of premium before operations were suspended. The scheme was possibly one of the most comprehensive ever conceived. Facilities were provided for the "hedging" of the foreign exchange rate, and the exporter could quote in either dollars or foreign currency and the exchange would assume all of the burden. The company also fostered C.I.F. shipments and was quite willing to write a policy on this basis as F.O.B. The management claimed that the company ceased doing business, not because it failed, but because it was not organized on a large enough scale to continue. Attempts have been made, therefore, to reorganize the exchange on an enlarged basis and assume the same risk as before.

**"For Account of London Underwriters."**—Recently a type of credit insurance certificate has appeared in the American market which protects the insured against losses on specific shipments of specific commodities, which commodities must be staples. The amounts insured in specific cases are sometimes very large, but the underwriters do not assume more than 75 per cent of the ultimate net loss. Furthermore, the insurance

is limited to losses on accepted bills of exchange only when caused by insolvency.

**Availability of the existing foreign credit insurance facilities.**—The companies are feeling their way cautiously in this new field because they are well aware of their lack of data on which safely to proceed in an unlimited fashion. In 1920, before the American Manufacturers' Foreign Credit Insurance Exchange actually began writing insurance, it organized a field staff to explain the advantages of membership to the exporters. Recently this staff has been augmented and the company is now actively engaged in direct solicitation from the exporters. This expensive method is considered necessary owing to the many problems involved, and the promotion is not to be intrusted to the regular insurance broker. However, this insurance is available to practically all American exporters including export merchants and commission houses who desire it, and for shipments to almost any country of the world.

In the case of the Trade Indemnity Company, policies are issued to British subjects covering exports to any part of the British Empire, and they are also issued to foreign exporters on merchandise shipped to merchants located in the British Empire including protectorates and mandates. There seems to be no great effort on their part to issue coverage to foreign exporters and applications must be made direct.

The certificates of insurance for the account of London Underwriters on specific commodities, such as cotton, are available through some of the regular insurance brokerage offices. However, there seems to be some hesitancy about advertising the insurance and coverage seems to be more sought after by the exporters than purchasers of the insurance are sought by the underwriters.

## Chapter IV

# THE TYPES OF CREDIT INSURANCE COMPANIES[1]

Two principal types of companies have appeared in the field of foreign credit insurance. One is the regular stock company, and the other is the reciprocal mutual. The stock company issues policies of the greatest variety, but the reciprocal has made more progress. This is because there are certain features in connection with credit information which are feasible only where there is some system of mutual co-operation for clearing credit data, and a centralized system for the general use of any company has not been devised.[2]

**The stock company plan.**—The stock company plan of operation is similar to that found in other lines of insurance. That is, the company issues policies through agents and representatives, gives the benefit of a fixed and predetermined premium, and does not subject the policy holder to possible assessments or other contingent liabilities. Stock companies have not, however, been able to grant as liberal a form of policy as the mutuals. This is probably because their credit information is not as accurate as the mutuals have been able to obtain by means of the system about to be described. They have also tried to limit the coverage to accounts that are submitted to them and approved before the policy is issued, and in any event, they have refused 100-per-cent protection. The companies that have entered the field of foreign credit insurance are for the most part companies that have been started for that purpose, although some of the older bonding companies have been much interested in it, and the reinsurance, in some cases, has been assumed by old, established companies.

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[1] At the present time the American Manufacturers' Foreign Credit Insurance Exchange is the only mutual company writing in the United States, and the Trade Indemnity Company, Ltd., of London, is the only stock company writing policies on a standard form. Consequently the greater part of the analysis which follows is based on these two companies.

[2] See page 102.

**The mutual plan.**—From the very beginning some of the pioneers in this field have maintained that the only scheme that could be permanently successful was one that would be operated as a mutual in order that credit information could be safely exchanged. Recognition of this fact may be attributed to the conditions which existed prior to any credit insurance and which still exist in many organizations. The reference is to the exchange of credit information in different foreign trade organizations in the various industries where the members found it profitable. This system virtually amounted to partial insurance in itself because, if a bad risk existed, at least one member would probably find it out before all of them had been unfortunate enough to extend credit.

It was this idea which was transplanted into reciprocal mutual foreign credit insurance. The founders of this type of credit company maintain that it is absolutely necessary to use such a method in order to obtain the interchange of credit data as described later under "Sources of Credit Information." In this type of company each member is an insurer of the other members. In other words, it is inter-insurance.

Since it is impractical for each member to exchange a contract with every other member, the same end is accomplished by each subscriber appointing a common representative for all of them. This representative takes the form of an incorporated attorney-in-fact. When a person desires to become a member of the insurance exchange, he makes his application and contract through this incorporated attorney-in-fact, giving it certain powers and assuming certain obligations himself. Since this contract is essential to the plan and must be made before a subscriber can obtain any insurance protection, it may be advisable to give a description of it.

**Analysis of the subscriber's contract.**[3]—For purposes of analysis the contract can be divided into two parts: (1) The duties and privileges of the applicant, and (2) the duties and privileges of the incorporated attorney-in-fact.

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[3] The Subscriber's Contract of the American Manufacturers' Foreign Credit Insurance Exchange. See Appendix I.

1. Duties and privileges of the applicant:

(*a*) The applicant agrees, that the incorporated attorney shall have the power in his place and stead to make, subscribe, issue, change, modify, reinsure, or cancel contracts exchanging foreign credit insurance and/or containing such terms, clauses, stipulations, statements, and warranties, as it shall deem best. The foregoing is subject, however, to these limitations: (1) That the insurance and indemnity exchanged for him shall be in the proportion which his earned premium during any fiscal year of the exchange bears to the total of all premiums earned by the exchange for such fiscal year. (2) That the total of such insurance and indemnity exchanged together with taxes, department fees, and adjuster's and attorney's fees, court costs, and all other expenses of any kind shall in no event render the member liable for more than once again his earned premium during any such fiscal year of the exchange.

(*b*) He must furnish ledger and sales experience on any foreign buyer and a synopsis of credit information in the member's possession upon any specific buyer when called upon by the exchange so to do.

(*c*) The member is to be allowed to cast one vote in electing each of the seven members of the Board of Trustees.

(*d*) He agrees that all credit guides which are in his possession are the property of the incorporated attorney and will not be sold, rented, loaned, or given to any other person, firm, corporation, or other organization.

(*e*) The final ratings on any foreign buyer made by the attorney shall govern exclusively all shipments under the master foreign credit insurance policy.

(*f*) A premium deposit, which is subject to monthly adjustment as premiums are earned, is to be made with the incorporated attorney.

(*g*) He has the right to terminate the contract at the expiration of any contract year by giving the attorney sixty days' notice in writing.

2. The duties and privileges of the incorporated attorney-in-fact and its manager:

(*a*) The incorporated attorney-in-fact agrees to obtain the insurance which the applicant has requested and is given the power to place it in the manner described above.

(*b*) He has the right to give, waive, or receive all notices or proofs of loss; to adjust and settle all losses and claims on such insurance contracts; to perform or waive all such stipulations of any such contracts; to appear for the subscriber in any suit, action, or proceeding and bring, prosecute, defend, compromise, settle or adjust the same and perform every act not specifically mentioned that the subscriber could do in relation to any foreign sale or contract.

(*c*) Any ledger or sales experience and credit information furnished by a subscriber is for the confidential use of the manager and attorney-in-fact.

(*d*) He must give each subscriber at least ten days' notice of the annual meeting of the Board of Trustees.

(*e*) A separate individual account must be kept for each subscriber and joint funds are not permitted.

(*f*) Provision is to be made for the safe-keeping of subscribers' funds.

(*g*) He receives as his full and entire charge 30 per cent of the earned premiums. Out of this he must meet and pay all costs of operating the exchange, except taxes, fees of insurance, attorney fees, court costs, telegrams, cable tolls, the per diem and expenses of the trustees, and all other necessary costs and expenses of handling, investigating, adjusting, and paying claims and losses.

(*h*) He has the right to make disbursements from funds of subscribers by check. The attorney may be required to give such bond as the Board of Trustees sees fit.

(*i*) He has the right to terminate the contract at the end of any contract year by giving sixty days' written notice.

(*j*) Refunds of any savings are to be made to the subscribers when the Board of Trustees so designates.

(*k*) He is required to renew automatically all negotiable foreign credit insurance certificates at the prescribed renewal premium rates until instructed by the subscriber that further renewals are not required.

The fact that such a contract is necessary leads many persons to criticize the organization because their experience with similar contracts in other reciprocals has not been satisfactory. Usually these unfortunate experiences are traceable to the inherent nature of the reciprocal.

**Features peculiar to a reciprocal mutual.**[4]—The ordinary reciprocal is not a corporate body, although it may operate through an incorporated attorney. The policyholders do not know the identity of one another, but each has assumed an indefinite liability to the others. It has been aptly described as a partnership where the partners are silent until insolvency occurs; then only does their money talk. Usually the members have no voice in the management except through an advisory board elected from their own membership, but since the attorney-in-fact retains the right to terminate a subscriber's contract, he can easily change the advice he does not like because if a subscriber's contract is cancelled, he is put off the advisory board.

The liability is sometimes limited, but if the attorney retains the right to perform any act in relation to a policy that the policyholder himself could perform a legal question might be raised to ascertain whether the attorney could not change the liability, if he so desired. Another angle concerning liability might be considered. It is provided that a summons may be served against the attorney, and he may accept process for each of the members. Some jurisdictions have held that one process on the attorney is sufficient to cover all of the members, inasmuch as the attorney is their agent. Still another feature should be observed. The subscriber's liability for loss, occurring while he was a member, survives as long as the liability of the exchange continues, even though he has severed his connections in the meantime. Then, too, so-called third-party insurance must be considered since the courts have not upheld limited liability where third parties are concerned.

Other things peculiar to the reciprocal are: (1) the power given

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[4] "Fundamental defects in Reciprocal Insurance," by Claris Adams in an address before the Indiana Association of Insurance Agents, at Indianapolis, on January 19, 1923.

Miscellaneous pamphlets on, "Reciprocal Insurance," published by the Casualty Information Clearing House, Inc., Chicago, Ill.

to the attorney to settle the losses, which places him in the anomalous situation of having the right to compromise both sides of the claim, and (2) the fact that he always deducts a fixed percentage of the premium as his compensation regardless of whether the insurance exchange has made a profit or suffered loss.

It is not surprising when the above conditions are considered that many persons are wary of reciprocal insurance. To add to the objectionable complications, some state insurance commissioners have excused companies of this type from reporting to the state, under the insurance laws, on the grounds that they are nothing more than mutual guarantee organizations.

In the main, the reciprocals which have issued foreign-credit insurance are exposed to the objections just described. However, they have attempted to make the advisory board more important by electing them for at least a one-year term and by giving them more supervisory power over the actions of the attorney-in-fact. This supervision has taken the form of regulating the premium which the attorney charges, the amounts he pays out, and the controlling of dividend declarations. Another safeguard is the provision in the contract requiring the attorney to maintain an individual account for each member; no joint funds are permitted. Furthermore, sixty days' notice is necessary in order to cancel, and a risk that has attached cannot be cancelled during the period for which it is scheduled to run.

## Chapter V

# THE CLASSIFICATION OF CREDIT INSURANCE POLICIES[1]

The various types of insurance policies which have been used during the last few years to insure the extension of credits in foreign trade may be grouped under the following headings: (1) Unit or mass coverage. (2) Nature of risk. (3) Limited or unlimited coverage. (4) Full or fractional coverage. (5) Duration of protection. (6) Types of protection. (7) Methods of loss adjustment.

**Unit or mass coverage.**—By unit coverage is meant protection for individual shipments, as contrasted with mass coverage, which takes care of all shipments falling within certain limitations. The type of protection which has been demanded by the exporters is one in which they can declare individual shipments, on which they desire protection, and assume the responsibility for the balance of the shipments themselves. In response to this demand the companies operating on a mutual basis have provided policies which enable the insured to select the shipments on which he desires protection. The method of operation in these cases is to issue a so-called master policy[2] and then, when a shipment is made where protection is desired, the exporter makes a nomination of shipment[3] to the insurance company, and if the risk is considered as insurable, a rate is quoted. Then, if acceptable to the exporter, a certificate of insurance[4] is issued. Thus, the master policy can be regarded as an open policy that permits the insured to declare those shipments on which insurance is desired, and it is furnished

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[1] This chapter is based on the various stock company policies issued by the Trade Indemnity Company, Ltd., of London, and except where otherwise noted the mutual company policy is that of the American Manufacturers' Foreign Credit Insurance Exchange.

[2] Appendix II.

[3] Appendix III.

[4] Appendix IV.

him in the form of an individual negotiable insurance certificate. This enables him to transfer it readily to another party, such as a bank, for the latter's protection.

Where mass coverage is used, a blanket policy is issued in which the insurance company states that all shipments which meet certain qualifications are automatically covered. Two principal forms of such insurance have appeared, the one in the form of an excess loss policy, and the other in the form of a general policy.

*Excess loss.*[5] The excess loss policy is very similar to the form issued by domestic credit insurance companies in the United States. That is, a certain percentage of the total sales turnover of the insured is assumed to be a normal loss due to bad debts, and is borne by the insured the same as any other known cost of operation. Only the excess over and above such normal loss is covered by the insurance company, and this is subject to a percentage deduction.

*General policy.*[6] The general policy protects the insured against loss on any of his accounts that comply with certain requirements, without any deduction such as in the excess loss policy being made in order to ascertain if the insurance company is liable for payment. However, the insured usually will have to be a co-insurer to as large an extent, for example, as 33⅓ to 50 per cent of the amount of the loss.

**Nature of risk.**—The nature of the risk may be divided into the open account, resale loss, bill of exchange, demand draft, time draft, and time sight draft.

*Open account.*[7] Naturally the open account needs more protection than any other type of credit risk. In these cases the insured does not hold a lien against the buyer, and if the latter fails to settle the debt the exporter will usually rank as a general creditor, since he is not in a preferred class, nor does he hold any particular powers over the goods in the possession of the importer. This makes it the most dangerous type of risk which

[5] Appendix VIII.
[6] Appendix VI.
[7] Appendix X.

the exporter incurs. Consequently, it is the risk he is most desirous of protecting, and since it is very hazardous, the insurance company has to charge a high rate.

*Resale loss.*[8] In the case of protection against resale loss the insured can collect from the company only providing a loss has arisen owing to the inability of the buyer to accept deliveries. When written by itself this type of coverage has a very limited field, inasmuch as insolvency is the one event insured against and losses will arise only when the consignee cannot accept because of insolvency. The shipper must be unaware of the insolvency of the consignee at the time of shipment, and, therefore, such insolvency as is covered will usually have to occur within a maximum period of about ten days before shipment is made and prior to the time of arrival of the consignment. It may be concluded that the field for such insurance is small and its importance limited.

*Bill of exchange.*—As contrasted with protection of the open account, insurance may be obtained where the exporter has made a shipment to an importer and the goods and draft have been accepted by the importer. In this case the importer's name appears on a negotiable instrument and the possibility of default is not very great unless insolvency occurs, because non-payment of an accepted draft would seriously injure the credit standing of any person committing such offense. Nevertheless, it is desirable to have insurance in such cases in order to eliminate the credit risk, and this will better enable the exporter to get a lower rate of discount at the bank.

*Demand draft.*—The insurance of the amount of a demand or sight draft applies only to the documentary draft and involves comparatively little hazard because the documents are placed in the hands of a bank and are not released until after the importer has settled his debt. Where policies of this type are issued, the extent of their protection, if insolvency is the only event insured against, practically amounts to that given under a resale-loss policy. However, if rejection is covered, it is a much more complicated form of coverage because the

[8] See pages 95 and 96.

rejection may be due merely to a decline in the market price of the goods. Needless to say, a very great moral hazard would also be involved in this case.

*Time draft.*—Time drafts may be "days from date" or "days from sight." Obviously the draft which is thirty "days from sight" involves a longer duration of risk than the one which is thirty "days from date," and a distinction must be made. Time drafts may also be divided into two other groups, depending on whether or not they are "documents against acceptance of the draft." When acceptance is required, they may fall into the category previously described as "bill of exchange."

**Limited or unlimited policies.**—Credit insurance policies may or may not have a face value. Then again they may have a limit as to certain customers or certain accounts that are specified in the policy. All these limits may be varied from time to time and adjusted when shipments are made.

In most of the stock company policies some face value appears on the policy. When sales aggregating the total of this sum are reached, further sales will have to be covered under an additional policy. These policies also frequently contain a list of customers to whom shipments may be made and protection granted. Where such is the case, it is customary to state the gross amount of outstanding credit to each one of the customers opposite his name in a schedule that is part of the policy.

In the case of the mutual company policies, no face value appears on the master contract because the premium is going to be charged on the individual shipments and there is no particular point in placing an aggregate limit on all shipments, except the maximum insurance capacity of the insurer. However, it is necessary to have a so-called "single account limit" that will apply to certain risks according to their credit rating. This is important because the capital strength and credit standing of many foreign buyers do not warrant the extension of unlimited credit and the insurance company must grade them accordingly. Another limitation is sometimes necessary, predicated not on the standing of the buyer, but on the ability of the insurance company to absorb the risk. Reference is had to

those cases where the insurance company cannot extend more than a certain given amount of coverage on individual buyers, owing to lack of reinsurance facilities. It will be observed from this analysis that, while the policies are divided into limited and unlimited coverage, all policies will necessarily have some form of limitation as regards the single account and the maximum line.

**Full or fractional coverage.**—A classification may be made on the basis of whether the insured obtains full indemnity for the loss sustained or whether he can collect only a portion of his loss. The only case where 100-per-cent protection is given is where the policy is an open one and insures only those specific shipments that are submitted to the company and declared by the company as acceptable to them for insurance purposes.

In the so-called general policy the insurance company assumes up to two-thirds of any loss.[9] This means that the insured will have to bear the other 33⅓ per cent so that in the end this protection does not eliminate his loss entirely, but merely decreases the burden which he must bear. In the excess loss policy he not only must bear all losses up to a given percentage of his turnover, but he is also regarded as a co-insurer on each and every credit to the extent of 10 or 20 per cent.[10] Where coverage is obtained on specific commodities such as cotton, a maximum of 75 per cent usually is assumed by the company, and the balance must be borne by the insured. The percentages mentioned above are those that are most frequently found, but any number of variations may be made to meet the exigencies of the situation. The American exporters have been very reluctant to accept any policy which does not assume the entire risk, and consequently, have not favored the fractional form of protection, especially since one of the usual conditions is that the balance must remain uninsured and warranted borne by the exporter.

**Duration of protection.**—Some policies provide that the

[9] See pages 82 and 83.
[10] See pages 83 and 84.

loss must occur within the original specified policy period while others permit an extension of this time. A policy which protects only for insolvency, which must occur within a specified time, is not much in demand because the proof of loss that is necessary according to insolvency definitions may take considerable time, and since most all policies run for a maximum of one year, it necessarily follows that this type of policy can meet only particular situations and does not take care of a general situation.

Therefore, most policies provide for an extension of the original period. This may be for a limited time such as three months, or for the full period under a regular renewal policy, or for an indefinite extension of the time. The latter is peculiar to unit-shipment coverage. In the case of the mutual company policy, where each shipment is declared separately, an insurance certificate is issued which protects for a specified number of days, known as the original period of time, and a premium is paid for this period. However, if the insured, for any reason, at the end of the specified number of days desires continuation of protection, it will be extended from month to month as long as the insured wants it, at a uniform additional monthly rate of premium, as long as the certificate stays in force.

**Types of protection.**—Two general types of protection have been given, one insuring against insolvency, and the other guaranteeing the integrity of the sales contract as well as the solvency of the buyer. The most common thing to insure is loss arising out of insolvency, because certain definitions can be given to the term "insolvency" which will minimize the moral hazard. It is customary for the policies to contain a complete definition of what shall be considered as insolvency and an explanation of these definitions is given in connection with the policy analysis found in another chapter.

When the integrity of the sales contract is guaranteed, it means that the company is assuming a very great moral hazard in connection with the rejection of goods or the repudiation of a sales contract. For this reason the companies are very reluctant to issue such policies, although the exporters are extremely

desirous of obtaining them because they know that, once the contract has been completed, they are sure of collecting from either the buyer or the insurance company. It is natural that where such certainty exists, the exporter may fail to use as much care in filling orders as where he must assume responsibility. Therefore, in order to eliminate this moral hazard, the insurance company must possess a great deal of information on both the buyer and the seller. Since much time and expense are necessary to gather such data, no company is as yet in a position safely to assume such risk. It is maintained by many that such a stage will never be reached because of certain inherent difficulties, but a discussion of this is reserved for a later chapter

**Methods of loss adjustment.**—Policies may be classified according to the time when a loss is payable or according to the method of ascertaining the extent of the company's liability. Inasmuch as this is a rather complicated subject, an entire chapter is devoted to an explanation of loss adjustments.[11]

[11] Chapter VIII.

## Chapter VI

## ANALYSIS OF THE POLICY[1]

In making an analysis of the features of foreign credit insurance the stock company form of coverage will be discussed in conjunction with the mutual. While there are differences between them in some respects, they are not deemed of sufficient importance to warrant separate treatment. However, in order not to confuse the operations of the two, reference will be made to the type of coverage to which the various remarks pertain.

**The application or proposal for insurance.**—If an exporter wishes a stock company policy, he makes a so-called "proposal"[2] to the insurance company indicating the protection he desires. The nature of the proposal and declaration depends on the type of policy that is desired. If it is "specific account" insurance, the applicant furnishes a list of the customers on whom he desires protection, stating the gross amount outstanding on each of them at any one time and the terms of payment. Since the stock company policies do not provide 100-per-cent protection, it is necessary to indicate what percentage is desired, up to the maximum percentage which the company will grant. The proposal is considered as part of the contract and the insured is given to understand that his declarations are for the purpose of fixing the premium. Therefore, care must be used in making up the schedule of customers, because a statement is required from the applicant to the effect that he knows of nothing which might influence adversely the acceptance of the risk by the company.

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[1] The mutual company policy analysis and practices are those of the American Manufacturers' Foreign Credit Insurance Exchange, except where otherwise indicated. The Trade Indemnity Company, Ltd., of London, forms the basis for the discussion of the stock company policies.

[2] Appendices V, VII and IX.

In the case of the "general policy"[3] it is necessary to furnish information of a somewhat different type since all accounts of a particular kind are covered. A statement must be submitted showing the sales turnover for each of the preceding five years, the aggregate net losses, and the largest individual losses for each of these years. In addition, the usual period and terms of credit must be given along with the countries to which shipments are made, the sources of credit information usually used, a promise to use reasonable precaution in granting credits in the future, and the maximum individual credit on any one customer that the insured desires to have covered at any one time.

If an "excess loss"[4] policy is desired, the applicant indicates the "first loss" on his total sales turnover which he will bear. He also agrees to adjust the premium according to turnover, specifies the maximum individual account limit which the company is to bear, and the countries to which shipments are to be made. Any customers that have not been investigated through at least two specified credit information sources are excluded, except under certain conditions.

The application[5] to a reciprocal mutual company is really a part of the power of attorney, as described in the chapter on "Types of Companies." The applicant states his name, address, business classification, the date established, the usual terms of foreign sales, the approximate average yearly export sales, and the designated annual basis on which he desires his membership in the insurance exchange to be. He also states that he desires to secure protection against loss due to insolvency of foreign debtors and requests a master policy, appointing the attorney-in-fact as his agent to obtain this protection for him. This merely takes care of the master policy, and since coverage is on a unit basis, a separate application for insurance must be made each time a shipment is to be protected. This is accomplished through what is known as a "Nomination of Shipment" which is described later.

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[3] See Appendix V.
[4] See Appendix VII.
[5] See Appendix I.

**Parties to the insurance contract.**—In the case of the stock company there are but two parties to the contract, the insured and the company. However, in the case of the mutual the situation is more complicated. When the incorporated attorney approves the signed application and contract which the applicant has filed with him, a master policy is issued. The primary purpose of the contract with the attorney was to clothe him with power to exchange foreign credit insurance and indemnity with the other members of the exchange. He now uses this power and issues a policy. This policy contains a statement that the other subscribers to the insurance exchange agree severally in their respective proportions to insure the subscriber in accordance with the terms of the contract, and he reciprocates in like manner to them. Thus, the attorney has acted as agent for the different subscribers and facilitated the process whereby each member insures the other through this inter-insurance arrangement. The attorney has other powers which are of vital importance to the contract, as previously explained.

**Consideration.**—The stock company consideration is the premium paid by the insured. This may be a premium paid for the estimated turnover of the business and subject to adjustment at the end of the policy period, as, for instance, in the case of mass coverage; or it may be a stipulated sum on an aggregate amount of specific account sales. It is also agreed that all the endorsed conditions, and the declaration and proposal made by the insured, are a part of the contract; any misstatement, or material omission in reference thereto will make the policy void. The mutual company provides that the consideration shall be a minimum deposit premium based on estimated sales, and other premiums which are paid from time to time when foreign credit insurance certificates are issued covering specific accounts. A further consideration consists of the statements, stipulations, and warranties contained in the application and contract, all of which are, by the acceptance of the policy of insurance, warranted to be true. In return for these aforementioned considerations on the part of the insured the companies promise certain indemnity as specified in the several

policies, a more detailed explanation of which is given in a later part of this chapter.

**Term and renewal.**—The ordinary policy period is one year with either type of company. The stock company policies insure shipments meeting the policy qualifications, if made and delivered within the time limits of the policy. If this policy is renewed at the end of the period, all outstanding risks are carried over into the new period.[6] In some policies, if the due date for the bill does not occur until after the expiration of the policy period, a similar provision exists whereby the insurer assumes liability if the policy is renewed.[7] Reference is seldom made to cancellation except where the insured becomes a bankrupt, or insolvent, in which events the policy lapses.

In the case of the mutual company policy, it is provided that the policy shall automatically renew itself for successive years unless it should be cancelled in accordance with the provisions which have been described in the contract with the incorporated attorney, which permit cancellation upon sixty days' notice.[8] The one-year period applies to the master policy but since nothing is covered unless a separate insurance certificate is issued, the term of this certificate must also be considered. It is customary to designate the period for which coverage is desired, and this is known as the original period. The exchange automatically renews this insurance for successive periods of one month at a time after the requested period has elapsed, unless the subscriber notifies the exchange that the insured shipment no longer necessitates the continuation of insurance. In other words, the subscriber's account at the exchange will be charged for insurance at the specified rate for each month that the shipment remains unpaid, and it is presumed to be unpaid until the subscriber notifies the exchange otherwise. This procedure may continue indefinitely as long as the master policy is not cancelled, and in fact, it is required if protection is desired. In this

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[6] See Appendices VI and IX.
[7] See Appendix VI.
[8] See Appendix II.

way the exchange can maintain complete supervision over all insured accounts and it aids them greatly in keeping their credit file up to date. It should also be mentioned that a grace period of thirty days is given, for which there is no extra premium charge.

**The amounts covered.**—In the stock company policies the amounts covered are always fractions of the value of the indebtedness, varying from 50 to 75 per cent.[9] Then, too, there are other limits which must be considered. Sometimes there is an aggregate value of all shipments, always a single account limit, and frequently a limit on specific accounts. In the case of the excess loss policy, only amounts above a certain minimum loss are covered.

The type of coverage granted by the mutual is 100-per-cent protection and on a unit basis only, *i. e.*, there is no indiscriminate mass coverage on the total foreign sales of a given subscriber, but each individual shipment must be covered separately. This is accomplished by the issuance of a so-called negotiable insured. With such a certificate the subscriber has a chance to transfer the risk in those cases where he is doubtful of the credit status of his customer, and self-insure where he knows the customer is a good credit risk. On the other hand, it gives the insurance company a chance to reject the shipments to those foreign buyers whom they do not desire to insure.

Compulsory submission of each shipment to the exchange for insurance, even though the exchange refuses protection, has been proposed by one mutual. This would eliminate the adverse selection which might exist in the other method. It should be mentioned that there is a justifiable reason for refusing insurance inasmuch as the scheme is in its infancy, and it will take considerable time to complete credit files which will enable accurate and fair disposition to be made of all cases submitted for insurance purposes. In the meantime, it does not seem advisable to require each foreign shipment to be submitted, because the necessary information to accept, rate, or reject might not be available.

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[9] See Appendices VI, VIII and X

**The single account limit.**—Insurance covering single accounts naturally has limits in both the stock and mutual company. An insurance company does not wish to guarantee payments of an unlimited amount on individual buyers because of two things: (1) The credit of the buyer might not warrant such protection, and (2) the reinsurance facilities are limited, and it would be contrary to insurance principles to take an unlimited risk where there was little possibility of distributing the burden. The insurable amount on a single account is not determined in an arbitrary manner, but by taking into consideration the following things:

(*a*) The financial responsibility represented;
(*b*) The nature, extent, and respective proportions of known resources and obligations;
(*c*) The moral risk;
(*d*) The lines of merchandise handled and facilities for turnover;
(*e*) The tendency (or necessity) to scatter or restrict purchases with many or few sources of supply.
(*f*) The number of known sources of supply.

This account limit must be viewed from the standpoint of the total amount at risk on any one buyer for the account of those who have been insured. The method of ascertaining this is by requiring each of the insured to notify the company when a risk commences and when it ceases. In the mutual this procedure is much facilitated by covering only those shipments which are specifically insured. This is done by means of a certificate of insurance which is automatically renewed at the expiration of its original period. As previously noted, these renewals are successive monthly, and a premium is charged against the insured until he notifies the exchange that payment has been made. Consequently, he notifies the exchange promptly when liability is discharged. Through this system the exchange always knows whether the available insurable credit line has been used up because it will debit the buyer's account with all invoices insured and credit him as he makes settlement for his shipments.

**The rate inquiry.**[10]—In the mutual, where the unit shipment method of coverage exists, means to avoid difficulties arising out of the single account limit have been devised. If the member is undecided whether or not to do business with a buyer, he may wish to find out if he is insurable. This is accomplished by means of a so-called rate-inquiry blank on which he states the following: Name, business, and address of the buyer, the approximate amount of insurance that may be desired, terms and approximate date of shipment, class of merchandise, credit information on file, previous ledger experience, and references. The exchange will reply as quickly as possible, quoting a rate and the amount for which the importer is insurable, or they may inform the member that the account is uninsurable. In the latter case they will state their reasons, which are to be kept confidential, and the member is to notify the exchange if he has information which does not warrant the refusal to insure. If the rate is quoted, the member is not obligated in any way to accept and insure, but if he does desire to fill the order and insure, he will have to accept the rate immediately or run the risk of change. He runs the greater risk, however, that the insurable line may be used up, and the only way to reserve this is through a so-called "Nomination of Shipment."

**Nomination of shipment.**[11]—The nomination of shipment referred to in the preceding section constitutes the application for an insurance certificate and is the only manner in which the application will be considered. If the member decides to take advantage of the rate given in reply to his rate inquiry, he will nominate a specific shipment for credit insurance. This nomination contains the name and address of the buyer, amount and date of the invoice, terms of sale, amount of insurance, if partial coverage is wanted, and the original period for which the insurance is desired. In addition, the consignor policy-

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[10] "Instruction for Using the Service," American Manufacturers' Foreign Credit Insurance Exchange.

[11] See Appendix III.

holder agrees to assign his right, title, and interest in the shipment to the incorporated attorney, and gives the latter power to act for and in his name if, in the attorney's judgment, the insured interest is in jeopardy after the shipment has been accepted for insurance. Together with the nomination, the policyholder must furnish all the credit information, ledger experience, and other data which he may possess concerning the importer upon whom he desires insurance protection.

When this nomination is received, it is passed upon by the attorney, and if insurable, a certificate of insurance is issued. However, it may be that the insurable line is closed because of the account limit placed by the exchange, in which case the exporter is unable to obtain insurance coverage. This might mean that an exporter would accept an order, manufacture the product, and then find that when he is ready to make shipment it is impossible to get insurance. In order to avoid this situation, he is permitted to reserve that part of the insurable line which he desires. This is accomplished by making a nomination of shipment as soon as the order for export has been arranged. However, such action absorbs a part of the company's insurable line on the risk in question, and it would not be fair to other policy holders to reserve the line for any member against the remaining members, free of cost. Therefore, the premium charge is made from the day that this "approximate" nomination of shipment is declared. The company does not issue a regular insurance certificate at this time, but merely a binding acceptance, in which they agree to issue the certificate when the exact date and amount of the shipment become known.

This procedure has several advantages besides assuring the member of the availability of the insurance when a shipment is made. As previously stated, he pays the premium at the regular rate from the time that the insurable line is reserved, and since this is the case there is no reason why he should not be protected from that time. In other words, the manufacturing exporter may, through this method, obtain protection before he begins to manufacture the goods and the exchange is liable just the same as if the shipment had been made. There is also another advantage in that the policyholder will get the benefit of the rate

quoted on the importer at the time of the nomination, which is binding on the exchange even though circumstances might warrant considerable change by the time the merchandise is ready for shipment. It should be stated here that while insurance can be obtained at any time before shipment, the member is not allowed to insure after he has delivered the merchandise to the buyer or his agent. To facilitate further the smooth workings of the exchange in this connection, the policyholder is permitted to notify the underwriters of the foreign buyers in whom he is interested and then if a change of rate occurs or if the maximum insurable line is reached on certain buyers, he is immediately notified. When the ban is lifted he receives another notice and thus is always quickly advised of the status of his actual and prospective customers.

**The certificate of insurance.**[12]—When the exchange accepts a nomination of shipment as insurable, a certificate of insurance is issued. This certificate states specifically the shipment that is insured, giving the amount, the premium, terms of the sale, the beginning and ending of the insurance, etc. In case of loss, it is provided that the loss is payable to the last-named endorsee and that, for purposes of collecting a loss or claim, this endorsee has the same rights as enjoyed under the master policy. The certificate is thus made negotiable and the original policyholder can use it to secure a loan made for the purpose of helping him to finance his export transaction.

Automatic renewal is provided for under the terms of the certificate. The procedure in such event is as follows: When the insured receives payment for his shipment, he is obligated to inform the underwriters and the insurance is terminated. If, at the end of the original period of the certificate, no word is received by the underwriters within a specified number of days that payment has been made, a renewal notice is issued, extending the insurance for one month. The insured is now required to furnish a statement indicating the reason for non-payment. Non-payment may be due to insufficient time under

[12] See Appendix IV.

the original certificate for the buyer's remittance to be received, or to the fact that the creditor has asked for an extension of time or is unable to pay. In any event, the insurance is renewed for successive periods of one month each until the final payment of the account has been reported, or until the member notifies the exchange that renewals are no longer desired, or a claim in connection with the insured account is admitted against the exchange. This procedure means that the insured is always well protected and at the same time he will be careful to report promptly his "pay experience" on his foreign buyers. Otherwise he will be compelled to pay the renewal premium. It also is a means of the exchange keeping informed on the credit status of the foreign buyers, and automatically keeps the maximum insurable line on individual accounts available for insurance.

**Events insured against.**—At the present time no company is insuring against the happening of any event except insolvency. For a short period during 1922 one mutual guaranteed the integrity of the sales contract, involving the commercial risk of rejection; no other companies are assuming this risk at present although attempts to undertake such insurance are being made in several quarters. It is claimed by many that the moral hazard involved in covering anything except insolvency as defined by the policies is uninsurable. In the case of the general policy and the excess loss policy, it is usually provided that only those losses shall be covered that arise out of granting credit in connection with sales, resales, consignments, or shipments of merchandise to buyers acceptable to the insurance company or to buyers meeting certain requisites.

**Definition of insolvency.**—Since the word "insolvency" is open to so many interpretations, the policies state what shall be included in the term. In the case of one mutual, a foreign debtor shall be considered insolvent under the terms of the policy when it shall be established that:

(*a*) "The aggregate of the property of such debtor at a fair valuation shall not be sufficient in amount to pay his debts and such debtor shall have failed to pay his debts as they matured without legal excuse therefor.

(*b*) "A voluntary petition in bankruptcy or insolvency shall have been filed by the debtor according to the laws of the country in which the debtor resides or has his business establishment or the debtor shall have been adjudicated a bankrupt or insolvent.

(*c*) "The debtor shall have made an assignment of his assets for the benefit of his creditors.

(*d*) "The debtor's stock in trade shall have been sold under a writ of execution.

(*e*) "A writ of execution or attachment in the jurisdiction where the principal place of business of the debtor is located shall have been returned unsatisfied.

(*f*) "The debtor shall have compromised with a majority in number and amount of his creditors for less than the amount of his indebtedness to them.

(*g*) "A receiver for the debtor shall have been appointed and confirmed in a bankruptcy or insolvency proceeding.

(*h*) "A certificate shall have been made by the attorneys for the underwriters, to the effect that the account is "not collectible at law," which certificate may be based upon evidence submitted either by the member or by the underwriters.

(*i*) "The debtor shall have transferred or sold in bulk his stock in trade without having made due and proper provision for the full settlement of his indebtedness.

(*j*) "The debtor shall have absconded."[13]

A much briefer statement is contained in a stock company policy which provides that insolvency shall exist when:

"An adjudication in bankruptcy has been made or a composition arrangement in legal form has been agreed to by the creditors generally or, a legal Assignment has been executed for the benefit of creditors generally, or in the case of a Limited Liability Company an order has been made for the same to be liquidated either compulsorily or under supervision, or a resolution has been passed in legal form authorizing voluntary liquidation provided such resolution is not for the purpose of reconstruction."[14]

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[13] See Appendix II.

[14] See Appendices VI, VIII and X.

**Salvage.**—Both of the definitions given above throw the burden of proof on the insured. If he does not have foreign representatives, he is not usually in a position easily to obtain the necessary information and proof of the importer's insolvency. Recognizing this difficulty, the pioneer mutual has established a legal and salvage department operated by a large international law firm with offices in many parts of the world. Their policy provides that in the event of a period of three months elapsing after the maturity of the original insurance certificate without the debtor having settled and it appearing to the underwriters that legal steps should be taken to collect the amount due, the underwriters may require the insured to place the account in the hands of their legal department, or in the hands of an attorney selected by the member and approved by the underwriters. Failure to comply with this will result in cancellation of the insurance or refusal to renew. This feature, however, is not obligatory upon an assignee who has acquired the insurance protection in connection with the negotiable certificate of insurance as previously described, and cancellation will not result because of his failure to comply. Needless to say the party holding the certificate will usually be only too willing to avail himself of the opportunity to place the account with the legal department for collection.

The development of the salvage department will be a real service to the export business because it can avail itself of the facilities of such a department to make collections regardless of whether or not insolvency is the cause of the defaulted payment. It is to be hoped that this feature will acquire a position in foreign credit insurance similar to that enjoyed by the collection and salvage departments of the domestic credit insurance companies.

**Insurance of integrity of the sales contract.**—An attempt was made by one mutual to insure the sales contracts made with foreign buyers. Needless to say, no insurance could be accepted where the buyer did not have the highest credit standing. The information necessary to take such chances is much more detailed and difficult to get than where only insolvency is covered; consequently, it was impossible to begin on

a large scale and the company lasted only a few months. In addition to providing coverage in the event of insolvency as previously defined, the insurer also guaranteed payment in event of:

(*a*) "Rejection, without justifiable cause, of any consignment that is insured.

(*b*) "Repudiation of any bona fide sales contract wherein the merchandise is covered by the policy.

(*c*) "Dishonoring of any draft, acceptance, or like paper pertaining to a sale covered by the policy."[15]

The extent of the coverage is much broader than a hasty reading of the three brief sentences would lead one to conclude. The dishonoring of a draft or acceptance is the least dangerous of these because a written acknowledgment of indebtedness exists and the importer realizes that failure to pay will be known to the bankers, and his credit reputation seriously injured. Therefore, he will hesitate to take such a chance and the moral hazard is not very great. Repudiation of a sales contract, however, involves so many intangibles relating to the honesty of the seller, as well as the buyer, that protection against it might be considered as almost impractical excepting in the comparatively few cases of unquestioned reliability. In these cases such insurance protection very often is not deemed necessary by the exporter. The insurability of rejection has been the subject of many arguments and investigations by insurance companies and chambers of commerce and is important enough to deserve more detailed consideration, even though no company is assuming this risk at the present time; but further discussion will be deferred until the last chapter.

**Events excluded.**—In policies which cover insolvency only, a statement is sometimes made to the effect that losses resulting from trade disputes, disputed accounts, or rejected shipments are not covered.[16] This does not mean that the insurance against

[15] Policy of the Associated Exporters' Foreign Credit Guarantee Exchange.

[16] See Appendix II.

insolvency will be terminated if such conditions arise, but merely that no payments will be made for losses caused by such events. However, insolvency and bankruptcy sometimes are not covered, if a state of war between the country in which the insured debtor lives, and any other country is the cause of the insolvency or bankruptcy. Likewise, losses occurring after an insolvency act on the part of the insured are excluded under some policies.

**Suspension of the policy.**—One of the policies insuring unit shipments provides that if any foreign government declares a moratorium permitting suspension of payment on the part of the debtor, it suspends the insurance, but does not release the company from liability.[17] During the time the policy is suspended no additional premium charge is made.

Another portion of the same policy states that if a debtor defaults and submits a proposition to his creditors, showing that his aggregate property is sufficient to pay his debts, and requesting an extension of time for payment and a majority in number and amount of his creditors grant this extension, the liability of the insurance company is suspended, but not released, during that period, and no additional premium charge is made. Obviously the advantage of this suspension accrues to the insured as well as the insurer and it is not suspension within the usual meaning of the word as applied to insurance policies. The company is not called upon to make payment during the period, and at the same time, the protection against the events insured against continues for the benefit of the insured without his paying the usual renewal premium.

**Co-insurance.**—The provisions in practically all the policies virtually amount to 100 per cent co-insurance because the companies promise to pay only that proportion of any loss which the amount of insurance bears to the total value of the insured risk.

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[17] See Appendix II.

**Other insurance.**—If the insured carries any other concurrent insurance, he cannot collect a larger proportion from the insurance company than the amount insured by the exchange bears to the whole amount of such concurrent insurance. Such a provision is customary in most kinds of insurance and needs no explanation.

## Chapter VII

# THE PREMIUM

**Method of quoting.**—The manner of quoting the premium varies with the different types of policies. If it is a stock company policy, covering up to a limited aggregate on specific accounts or unit shipments, it may be expressed as a flat sum. If it is a general policy or an excess policy, it will be stated as a percentage of the turnover. In the last two cases, a premium is paid at the beginning of the policy based on the estimated sales during its term. It is then adjusted at the end of the policy period in accordance with the actual turnover, in a manner analogous to that used in connection with the payroll in compensation insurance. In no case, however, will the premium be less than a certain specified minimum.

If it is a mutual company policy, a premium will be quoted on each shipment that is covered, inasmuch as unit protection is invariably given in place of the blanket coverage. However, a deposit premium based on annual sales is made with the underwriters, who keep a running account with the insured and charge against it the amount of the premium each time a certificate of insurance is given. In this manner the company is able to obtain its money without waiting until the exact information on the premium is exchanged between the insured and the insurance company.

**Factors in rate-making.**—The most important things to be taken into consideration in determining the rate of premium to be charged for insurance against insolvency are as follows: (1) Credit rating. (2) Terms of sale. (3) Length of the credit.

Credit rating, which is the chief factor in determining the rate, is usually based on information obtained through one or more of the sources of credit information explained later. This information will usually indicate the antecedents, the general character and reputation of the house, the size of the business and its financial strength, the volume of turnover, the class of

merchandise handled, and the manner of payment as indicated by reports and interchange of ledger experience. The ratings used by one mutual company accepting unit shipments are divided into five groups: (1) High credit. (2) Good credit. (3) Fair credit. (4) A group where conflicting or insufficient information does not warrant a definite rating. (5) Another group where the data at hand are of a nature that they cannot be given out publicly. This usually means that the account is uninsurable. Another company has used four classes, dividing the importers into those that have: (1) Undoubted credit. (2) Good credit. (3) Medium credit. (4) Insurable credit.

The terms of sale will also have a vital effect on the rate to be charged. If the insurance is on an open account, there are many possibilities for the buyer to get into difficulty and not pay his debts, which would not arise if the terms were more definite and strict. In the case of time drafts, too liberal terms often lead the customer to overbuying and recklessness. Nevertheless, competition must be met and payment is of necessity often arranged with this fact in view, although such arrangements are valueless if the probable result is disaster. The alternative is to know the requirements of the buyer and to grant terms that involve automatic liquidation by means of time drafts. Where such drafts are released only against acceptance, the moral hazard is reduced to a minimum and, therefore, lower rate quotations can be made than where the insurance covers an open account. If it is a demand or sight draft, there is even less hazard than is involved in a time draft because the merchandise will be released only in case of actual payment.

The length of time is also important, since the longer payment is deferred the greater are the chances that the debtor will commit an act of insolvency. Usually the greatest length of time is in connection with the open account and the premium will be adjusted in accordance with the period. It is also necessary to distinguish between the rates on a time draft and a time sight draft since the first refers to the time the draft is dated, and the second to the date of sight. Thus, a sixty-day time draft, dated August 1st, runs for sixty days only, while a sixty-day sight draft may actually involve ninety days because

it takes thirty days for it to get from the exporter to the importer.

If the integrity of the sales contract as well as insolvency is guaranteed, it is necessary to take into consideration the credit rating of the seller, the nature of his business, his knowledge of the export business, the conditions or circumstances attending the trade to which the contract of sale pertains at the time the sale is made, the different markets likely to affect the trade, and the possibility of the transaction being of a speculative character. If these things cannot be accurately ascertained by the insurance company, the risk is bound to be very hazardous.

**The basic rate.**[1]—The basic rates on unit shipment insurance in the case of the mutual company using credit ratings of high, good, and fair are 1 per cent, 1⅛ per cent, and 1¼ per cent, respectively. These percentages are applied to the gross amount of the invoice that is insured. The period to which they apply is two months or less, and then only to sight or time drafts. When applied to an open account, each rate is increased by ¼ of 1 per cent. If protection is desired for more than two months, the rate is uniformly ⅛ of 1 per cent for each additional month so covered, regardless of the nature of the risk. In order better to understand just what is meant by this explanation of the rates a table illustrating them is given below.

TABLE OF PREMIUM RATES

| CREDIT RATING | BASIC RATE | SIGHT OR TIME DRAFT | | | | |
|---|---|---|---|---|---|---|
| | | CALENDAR MONTHS | | | | |
| | | 2 OR LESS | 3 | 4 | 5 | 6 |
| High | 1% | 1% | 1⅛% | 1¼% | 1⅜% | 1½% |
| Good | 1⅛% | 1⅛% | 1¼% | 1⅜% | 1½% | 1⅝% |
| Fair | 1¼% | 1¼% | 1⅜% | 1½% | 1⅝% | 1¾% |

[1] "Instructions for Using the Service," American Manufacturers' Foreign Credit Insurance Exchange.

| CREDIT RATING | BASIC RATE | OPEN ACCOUNT | | | | |
|---|---|---|---|---|---|---|
| | | CALENDAR MONTHS | | | | |
| | | 2 OR LESS | 3 | 4 | 5 | 6 |
| High | 1% | 1¼% | 1⅜% | 1½% | 1⅝% | 1¾% |
| Good | 1⅛% | 1⅜% | 1½% | 1⅝% | 1¾% | 1⅞% |
| Fair | 1¼% | 1½% | 1⅝% | 1¾% | 1⅞% | 2% |

As a matter of fact, each of these rates is actually for a longer period of time than indicated, because a period of thirty days' grace, for which there is no extra premium charge, is added.

There are also special basic rates which are applied from time to time in certain markets because of special conditions that may exist. These rates are uniformly 1 per cent higher than the basic rates previously quoted and are applied to the high, good, and fair credit ratings.

Although no company is at present insuring the integrity of the sales contract, it is interesting to note that the premiums quoted by a company formerly writing this type of business were only ⅞ of 1 per cent more than the premium charged when insolvency alone was covered. Just how scientific these rates were is not known, although it has been claimed that the information determining them was based on considerable sales experience during a period when much readjustment was taking place in foreign trade.

**Renewal rates.**[2]—The mutual type of company has made it obligatory on its part to continue insurance for a rather indefinite period after the original period has expired. As explained in a previous chapter, this renewal is arranged so that it is more or less automatic, with a uniform premium for each month that insurance is renewed. When it is considered that the longer the period for which protection continues the more likely a loss is to occur, the fact that the renewal premium rate is the same

[2] "Instructions for Using the Service," American Manufacturers' Foreign Credit Insurance Exchange.

for each month of renewal may appear surprising upon first examination. However, the great risk really is during the period for which the original certificate was issued because, if on account of the buyer's inability payment is not made within that time, the chances are that an act of insolvency will be committed. Therefore, the insurance company is merely succeeding in obtaining a greater amount of premium from the insured in the form of these monthly renewals until the very probable event insured against technically occurs.

**The credit guides.**[3]—The credit guides, explained later, which are issued by a mutual company virtually amount to premium rate books because the ratings that are used opposite the names of the various importers are expressed in terms of the basic rates of 1 per cent, 1⅛ per cent, and 1¼ per cent for the high, good, and fair ratings, respectively. An X is used to indicate that they do not have sufficient information to give a definite rating and XX to indicate that the account is most likely uninsurable. This system may be compared with that followed by the domestic credit insurance companies, where the insured ascertains from a credit rating book such as Dun's or Bradstreet's whether the account is included on the insurable list or not.

**Liability for assessments.**—The stock company charges a fixed and predetermined rate of premium and, if it is later found that the premium was inadequate, the stock company will have to bear the deficit. However, the reciprocal mutual policy has a provision whereby the insured may be compelled to contribute a larger amount to the insurance company than the rates which have been indicated. The maximum that may be so collected in addition to the rate charged for the shipments that a member has insured, is a sum equivalent to the total premiums that he has paid to the company for the protection received. In other words, he is liable for 100-per-cent

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[3] "Instructions for Using the Service," American Manufacturers' Foreign Credit Insurance Exchange.

assessment, or for any proportion of it, the amount to be determined in accordance with the proportion which his premiums bear to all premiums. The legality of limiting the assessment in the case of a reciprocal mutual to 100 per cent in addition to the earned premium has been definitely decided by the United States Supreme Court.

**Dividends.**—A participating provision is contained in the policies issued by the mutual, but so far no dividends have been declared. Naturally the stock company cannot be expected to run the risk of an inadequate premium and at the same time promise to return any excess if they find the premium redundant.

**Sources of credit information.**—All of the information needed to predicate rates is easily obtainable, except that which is the most important, namely, credit information. This is not because there is no credit information, but because it has not been assembled into useable form for the purposes of credit insurance. In order better to understand the methods of gathering credits, and the extent to which they are investigated, a rather detailed explanation of the different credit information sources is given below. These are the fundamental bases of the rates and underwriting policies of the companies.

This is not intended to be a complete description of each of the principal sources, but merely an analysis of them for the purpose of pointing out their advantages and shortcomings as information on which to base credit insurance rates, and in order better to understand the statements made later in connection with such data.

Extensions of credit to buyers in foreign countries ordinarily involve the examination or consultation of one or more of the following sources of information:[4]

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[4] "Export Merchandising," Walter F. Wyman, McGraw-Hill Book Company, New York, 1922.

"Theory and Practice of International Commerce," A. J. Wolfe, Chapters 14–17, inclusive, which is a reprint of "Foreign Credits," Special Agents Series, No. 62, Department of Commerce.

1. The exporter's own ledger experience with the customer under consideration.
2. Information from his salesmen and branch houses.
3. References sent in by the customer.
4. Reports from banks.
5. Reports of mercantile agencies.
6. Miscellaneous private and semi-public institutions or organizations interested in promoting foreign trade.
7. Interchange of ledger experience with other persons doing business with the prospective customer.

1. *Ledger experience.*—The exporter's own ledger experience is valuable if it extends over a sufficient period of time and has covered a sufficient number of shipments. However, this is frequently not the case and the figures taken from his own experience may show a very false picture of the actual situation. These figures are likely to be unreliable because the foreign buyer may be deliberately manipulating his payments in such a way as to mislead particular exporters who sell to him, *i. e.*, he may have a very consistently excellent record with certain individual exporters and a very poor one with others, the object of such manipulation being to get those with whom he has a good experience to extend to him large lines of credit.

2. *Information from salesmen and branch houses.*—The information that a salesman furnishes is usually optimistic. This is quite natural because the salesman often thinks largely of his commissions and naturally wants to see every order which he obtains approved by the home organization. The same general proposition is true of the branch houses but possibly not to quite as great an extent, because the different branch houses frequently are compelled to compete with each other in minimizing losses. Nevertheless, both are subject to the same common defects.

3. *References sent in by the customer.*—Export houses very frequently request that the customer furnish them with personal references. Usually these are not very difficult for the importer to supply. The principal objection to them is the fact that they are so easy to get; it is very rarely that a customer cannot find somebody who is willing to do him the favor of recommending

him. This, in fact, has been one of the most misleading sources of information obtainable. Some of the worst cases of fraud in foreign trade have been made possible by certain concerns building up excellent reputations in a given locality and then proceeding to purchase from exporters elsewhere. When called upon for references, they have little difficulty in obtaining the finest kinds of recommendations from their local friends, who are unaware of anything unfavorable about them. Consequently, it pays to be wary of references furnished by the customer, and for credit insurance purposes, such references are practically valueless unless they include nearly all of the persons from whom this particular importer makes his purchases.

4. *Reports from banks.*—Usually the bank with which the importer does his business can furnish fairly accurate information concerning him. However, it must be remembered that he is a client of the bank and they naturally do not wish to do or say anything that would be apt to drive away their own customer. Consequently, such information must be discounted; in fact, some of the most flagrant financial disasters have occurred after the most favorable information had been received from banks. The writer has in mind several cases that came to his attention where the credit information, the history of the firms, and everything else furnished by several banks tended to indicate that the risks were of an A-1 type. However, the experience which several exporting houses had with these firms was startling. These importers did not lack funds, but in dealing with foreigners they used very dishonest methods in settling their accounts.

The method followed was to pay promptly the first time they dealt with the exporter and then on the basis of this to obtain a large credit extension and start a dispute concerning the shipment. Claims for shortage, poor quality, or deterioration of the merchandise, were made in order to postpone payment, and then an offer to compromise would be made. The exporter would usually be glad to get off so easily, but in most cases would extend no more credit. This scheme was worked to perfection on United States exporters by several foreign importers until an organization interested in foreign credit information

took it upon itself to run the cases down. The ledger experience was obtained from the exporters known to have shipped to these houses and all such experience revealed similar frauds, the original shipment having been sent in each case because of the excellent bank references which these importers were able to furnish. The intention here is not to belittle the reliability of this type of information, but merely to show its inadequacy and to illustrate the importance of the interchange of ledger experience, which would quickly have revealed this situation.

Attention should be given though, to the credit files which some of the larger American banks are maintaining. These are particularly valuable in those cases where they have branches that collect first-hand information. If this material were made available by all the banks which have credit files, it would be of great assistance to a credit insurance company.

5. *Mercantile agency reports.*—The two well-known domestic mercantile agencies, Dun's and Bradstreet's, maintain foreign services.

At present the reports of these agencies are available upon the payment of a certain fee. The Dun agency requires an applicant for information to be a subscriber to their domestic service, or a subscriber to their regular foreign service. The fees charged vary from $3 to $10 for individual reports, and from $50 for a twenty-report subscription to an average of $1.25 per report for a subscription service of 500 reports or over.

The Bradstreet agency offers approximately the same service, except that they will supply single reports to non-subscribers providing they are reputable and responsible merchants. They also render some aid in the collection of accounts by recommending reliable representatives in foreign countries who perform such services. While the information thus supplied is usually reliable, the credit man cannot be any more sure of his accounts where credits are extended on the basis of foreign-credit reports than where they are extended on the basis of domestic-credit reports. Nevertheless, the information on foreign buyers which the agencies have in their credit files is very valuable and is capable of greater utilization.

Possibly one of the best sources that a credit insurance com-

pany can find is the mercantile agency report. There has been a tendency by some to criticize it, but apparently these critics do not realize the comprehensiveness of the information that has been compiled, or else they have been dissatisfied because the latest information on some buyer in whom they were interested was not available.

Take, for instance, the information compiled by R. G. Dun & Company.[5] Their reputation for accurate credit service in the domestic field is well known, but comparatively few are aware that they possess similar information which they have been compiling for many years on hundreds of thousands of foreign buyers. The agency began domestic operations in 1841, and in 1857 established a London office. This was followed by offices in Canada in the same year, and in 1858. They established offices in Scotland and France in 1872; in Australasia, in 1887; in Mexico, in 1897; in Argentina, in 1902; in South Africa, in 1903; in Brazil, in 1912; and numerous other offices in various sections of the world from 1857 to the present time.

From this it can be seen that the type of information which they possess on foreign buyers is not of the hastily collected variety, but rather that which has been obtained over a long period by immediate contact with the importers in distant countries, and that it is in accordance with the sentiment expressed in an old axiom used in the granting of credits to the effect that "you do not know a buyer unless you know his history." So for insurance purposes one need go only a step further and add the interchange of ledger experience, and a very excellent basis for credit insurance is established.

6. *Miscellaneous private and semi-public institutions or organizations.*—One of the organizations that has become a recognized center of information on foreign trade in general furnishes foreign credit information also to its members. This is the semi-public organization known as the Philadelphia Commercial Museum, which is subsidized both by the city of Philadelphia and by the state of Pennsylvania. Its service is not free, but the charges are moderate. The type of information

[5] "Foreign Credit Information," R. G. Dun & Company, New York, 1919.

furnished usually is not quite so detailed as that which some of the other organizations supply, but consists chiefly of information concerning the general condition of particular importers which is obtained by means of the museum's correspondence.

The National Association of Manufacturers maintains a so-called foreign-credits bureau, which has been in existence for over twenty years and is operated on a co-operative basis as far as the interchange of experience among its members is concerned. It makes a practice of furnishing a certain number of reports free of charge to the members of the association, and if any additional ones are desired, they are furnished at cost.

The Export Managers' Club of New York also exchanges information among its members. Other sources of credit information which deserve recognition are the American Manufacturers' Export Association, the Boston Export Round Table, the National Credit Office, reports obtained from various export journals, and the National Association of Credit Men, which maintains a foreign credit interchange bureau. This latter organization is of such importance, and is using a system of clearing credit information that is so admirably adapted to the purposes of a credit insurance company, that a rather detailed explanation of it is deemed advisable.

7. *Interchange of ledger experience.*—The two most important organizations operating interchange of ledger experience deserve separate treatment.

**The Foreign Credit Interchange Bureau of the National Association of Credit Men.**[6]—*Organization.*—The bureau referred to was started in September, 1919, as a mutual, co-operative, non-profit-making organization. The administration of this body was delegated to a group of Export Credit Managers, each of whom had specialized experience in various quarters of the globe. This group set about building up an extensive machinery to provide for a clearing house where the individual credit information and experience of the various

[6] Pamphlets and documents used by the Foreign Credit Interchange Bureau of the National Association of Credit Men.

American manufacturers, merchants, and export commission houses could be compiled and interchanged. At present there are about seven hundred concerns, representing nearly every export industry in the United States, which have joined the bureau and are in the process of exchanging data and obtaining valuable credit information. Any member of the National Association of Credit Men is eligible for membership upon payment of an annual subscription fee of $100, for which one hundred reports are supplied. Additional reports are available at $75 per hundred.

*Method of operation.*—This organization obtains its information from the various members of the bureau by an ingeniously worked-out plan of interchange of ledger experience. Each member, when joining the bureau, agrees to furnish the information that he possesses on foreign buyers. The bureau assigns code numbers to all the various names on its ledger, and when a member furnishes information, it is posted to the buyer's account and its source is indicated in code form. The original data are then returned to the member who supplied them and the buyer's ledger account does not reveal the informant's name, except to one who possesses the code.

When a member inquires for credit information on a foreign buyer, he gets the benefit of the tabulated experience of many exporters, which is reflected in this ledger account. It shows him the experience that numerous houses have had with regard to the prospective customer but does not directly reveal the source of the information nor any trade secrets.

*Analysis of contract.*—In order to accomplish the purposes of this organization it is necessary to have a rather definite contract because of the confidential nature of the data interchanged and the abuses that are possible if confidences are violated. Inasmuch as a foreign credit insurance company must use some such method to keep its files up to date in order accurately to rate, accept, and reject risks, a description of the provisions of this contract is given below.

The subscriber agrees to submit to the bureau a complete list of the names and addresses of his foreign customers and to supplement this list at monthly intervals. He is obliged to

give a prompt, full, and true statement of his experience with all parties upon whom the bureau requests information, and if he fails to make a prompt and truthful disclosure of experience requested from him, or wrongfully divulges information received from the bureau, his resignation may be requested. The bureau in turn agrees that it will treat all information furnished by a subscriber as strictly confidential and will guard his list of customers with the utmost caution. Under no circumstances will his name as a contributor of information be divulged without his consent, and no duplicate of it will be kept, except that which has been transferred to records which are kept under a code number. It will be observed that both parties are protected under this contract and yet all the members of the bureau are able to get the benefit of the sum total of the experience of a large number of exporters on particular foreign buyers. It is only by means of a compulsory arrangement that such information can be accurately collected, and subscribers will submit this confidential information only when they know they will be amply protected by such provisions as are contained in this contract. This furnishes an excellent illustration of the manner in which an insurance company can gather credit data.

*Extent of information compiled.*—The extent of the information furnished about a buyer is as follows:

1. How long sold.
2. Terms of sale.
3. Highest recent amount.
4. Date of last dealings.
5. Amount now owing.
6. Amount past due.
7. Number of days past due.
8. Manner of payment.
9. Rating.
10. Credit limited (if any).
11. Credit declined (with reason).

Number 8 (manner of payment) may need some explanation, since the information desired is more detailed than the phrase-

ology would indicate. In the first place, if it is an open account sale it should be indicated whether the customer discounts, pays when due, or is slow. Secondly, if he settles by draft, whether he anticipates payment, accepts and pays promptly, accepts promptly and delays payment, delays acceptance and pays promptly, delays both acceptance and payment, or makes unjust claims. The credit rating is also rather definite, and must be one of the following: high, good, satisfactory, unsatisfactory, or undesirable. This information is then compiled under each customer's code number, along with whatever other data that may have been obtained from other sources.

When a member sends in an inquiry, a copy of the customer's credit file containing all of this information is sent to him, and on the basis of it he may decline or accept the order. These are known as primary reports but the bureau also gets out supplementary reports, where possible, containing the following information: capital, volume of business, number of employees, relative size of house, general reputation, class of goods handled, languages of correspondence, character of business organization, name, age, or nationality of partners, etc. The foregoing is very important for insurance purposes because it is practically the same information which an insurance company requires in order to determine a rate.

**The American Manufacturers' Foreign Credit Insurance Exchange.**[7]—Although the primary function of this organization is insurance, it recognized from the beginning that in order to conduct a satisfactory scheme of insurance it would have to develop a better credit information agency than had ever before existed. To accomplish this, it immediately set about preparing credit guides on the various foreign buyers and provided means for their up-to-date maintenance after their inauguration.

It is the intention of the exchange eventually to cover the entire world, but at present only five so-called world zones are being considered. They are as follows:

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[7] "Instructions for Using the Service," American Manufacturers' Foreign Credit Insurance Exchange, Chicago and New York, 1922, 1923.

1. Latin America, which is further sub-divided into—
   (*a*) South America.
   (*b*) Mexico and Central America.
   (*c*) Cuba, West Indies, and Bermuda.
2. Australasia and Oceania.
3. The Far East.
4. The Scandinavian countries and Holland.
5. Africa.

For the time being Great Britain and the remainder of continental Europe are to be left alone, but will be taken up when conditions warrant. Thus far, two guides have been published, one for Latin America, and the other for Australasia and the Orient.

The "Latin American Guide" has been through three editions, the latest having appeared on January 1, 1923, while only one edition (August, 1922) has been published for the Orient. Neither of these guides indicates ratings on the majority of the buyers in the respective countries, but the ratings upon the buyers given are claimed to be quite accurate. This information is being kept up to date by supplements which are issued from time to time. The information contained in these credit guides is as follows: the name of the foreign buyer; his address; the line of merchandise handled; code number, and the credit rating. The credit rating is by far the most important item because it is used as a basis for the insurance rate. The ratings found in the credit guide correspond to the insurance rates previously described and are as follows: 1 per cent, 1⅛ per cent, 1¼ per cent, X and XX, meaning respectively, high credit, good credit, fair credit, no credit assigned, and write to the exchange for specific information. (The latter means the exchange has information which it will furnish upon application but will not print in a credit guide.)

In making up these market guides, the exchange has gone to great expense and has obtained the information from miscellaneous sources, principally the combined credit files of its members, although it receives information from agents and representatives stationed abroad who have made special in-

vestigations of the persons rated. It has also had the co-operation of seventeen international banking concerns possessing credit files of foreign buyers. Another source which is being developed is the interchange of credit information between the members of the exchange. In their contract it is provided that at the time of joining the organization they must submit data on all persons to whom they sell goods in foreign countries. They must also report periodically, or at any time when the exchange sees fit to call for information, on any and all of their foreign customers. Furthermore, they are under obligation to report at once any information which they may receive affecting the credit status of a customer rated in a credit guide.

The value of these credit guides is very hard to determine accurately, but it can be safely said that they not only serve as instructive references when it is desired to extend credit, but they also perform a very valuable function in presenting a pre-analyzed and picked market to a person contemplating entering the export trade. As an illustration of this, the Brockton-Rand Company (a subscriber to the exchange) claims that in soliciting business in Latin America they used the names of shoe manufacturers rated 1 and 1⅛, and that they secured seven very satisfactory sample orders as a result, and thus opened up a profitable South American business.

## Chapter VIII

## SETTLEMENT OF LOSSES

**Notice of loss.**—The different policies vary considerably as to the time when a loss is payable and the method of ascertaining the extent of the company's liability, but they are all uniform in requiring the insured to give prompt notice of any loss falling within the term of the policy so that prompt action may be taken to protect their interests. In fact, where the insurance is on a unit shipment basis, it is essential to telegraph the information.[1] The latter may seem an unnecessary requirement when compared with those of other kinds of insurance, but there is no form of insurance where notice of loss is so vital. This unusual importance may be attributed to two reasons:

1. Under the unit-shipment method a credit insurance company may be continually incurring additional risk on the buyer and if anything occurs which affects his credit standing it will wish to stop all further issuance of protection.

2. Credit losses are inter-related, *i. e.*, the failure of one firm to pay may ruin the credit standing of other firms whose consignments would be insured in the absence of the adverse information.

**Proof of loss.**—In all cases it is necessary to submit a proof of loss. The extent of this proof varies with the policies, but all policies have the same general characteristic, namely, that the burden of proof is on the insured. The time within which this proof must be submitted is frequently limited to some such period as ninety days after knowledge of cause of default, although this is interpreted liberally, and the insured is not considered negligent if the information cannot be obtained because of some reason beyond his control. For the things which might be considered as sufficient reason for payment of loss, the reader is referred to the discussions on "Insolvency" and "Rejection" in connection with the policy analysis. It is necessary for the

[1] See Appendix II.

insured to provide the insurance company with proof that one or more of the essential events has occurred. The insured usually submits a complete statement to the company showing all the details of the transaction, the nature of the insolvency, security held against the defaulted account, offers of the debtor to settle, steps taken to collect the claim, amount estimated to be recoverable, and copies of instruments showing deeds of assignment, appointment of referee in bankruptcy, and any other legal instruments available. If the company maintains a salvage department, the account is usually turned over to it for collection, or if they maintain a legal department suit may be instituted through it. These actions having been taken, the company is ready to adjust the loss. If the policy is one that insures integrity of the sales contract, a statement must be filed as to cause of rejection, repudiation, dishonoring of draft, or whatever the case may be.

**Time of payment of loss.**—Just when the company will pay, however, is not uniform in the several policies. Some provide that they will pay within seven days of satisfactory proof of the loss.[2] Others provide for payment within thirty to ninety days of proof of loss.[3] Still others provide that no payment will be made until the end of the insuring year,[4] and frequently it is provided that no payment will be made until the ultimate loss is ascertained.[5] In case of insolvency or bankruptcy, actual ascertainment of the loss may take several years because an extension of time may be granted and the debtor's property operated by a receiver or other designated party, in the expectation that all or a portion of the debt may eventually be paid. Inasmuch as these affairs usually wind up unsatisfactorily, it merely means that the insured has his payment of loss delayed until the necessary event technically occurs.

**Method of ascertaining extent of company's liability.**—This also depends on the type of policy under consideration.

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[2] See Appendix VI.
[3] See Appendices II and X.
[4] See Appendix VIII.
[5] "For Account of London Underwriters."

However, two general groupings may be made with reference to this feature, namely, the full protection policy and the fractional protection policy.

1. *Full protection.*—The full protection policy, where 100 per cent coverage is granted, applies only to unit shipments, but its clauses may apply to the net invoice value, or they may cover gross credit including cost, insurance, and freight. The coverage of the policy having been ascertained, this is used as the starting point from which will be deducted: (1) The amount of the discount to which the debtor would have been entitled, had the debt been paid at the date of insolvency; (2) all credits received on account; (3) goods returned or replevined, and (4) money realized or to be realized on any securities or specific guarantees.[6]

About the only time that difficulty will arise in ascertaining the amount due under this type of protection is when other insurance exists or when the insured has extended uninsured credit to the customer. Uninsured credits may be due to the refusal or inability of the insurance company to insure, or the desire of the insured to self-insure. Disputes will sometimes arise as to priority of rights in these cases, particularly where assignments are made or security is given to the insured because of the credit which he has extended to the customer. The policies, however, provide that the insured is supposed to share with the insurance company pro rata any salvage which may be obtained.[7] As far as other insurance is concerned it is usually provided that the company will not pay a larger portion of any claim than the amount which their insurance bears to the total of all such concurrent insurance.

2. *Fractional protection.*—Fractional protection should be divided into three groups because certain percentages are peculiar to certain types of policies: (*a*) Up to three-fourths of the net loss; (*b*) up to two-thirds of the net loss, and (*c*) 80 or 90 per cent of the excess loss.

(*a*) An agreed percentage up to three-fourthes of the net loss will be paid on the stock company policies covering resale loss,

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[6] See Appendix II.

[7] For illustration of the operation of this, see p. 97.

bills of exchange, open account, and time coverage. The balance of such losses must be borne by the insured and he is not permitted to transfer this risk to another insurance company. This is the usual method of ascertaining the extent of liability of each of these forms, although policies sometimes contain provisions facilitating the determination of net loss, and the resale loss policy considers items not involved in the other cases.

In ascertaining the company's liability in the case of resale loss, the procedure is as follows: Take amount realized by resale, deduct from it all reasonable expenses incurred by the insured in effecting a resale but not including any charges for interest. Deduct the result thus obtained from the original invoice value, apply the agreed percentage to this sum, and the result is the amount the company must pay.

Thus, assuming the original invoice value to be $30,000, the resale price $20,000, commission and other expenses of reselling 10 per cent or $2,000, and that the insurance company promises indemnity for three-fourths of the net loss, the liability of the insurer would be determined as follows:

| | | |
|---|---|---|
| Net Invoice Value | | $30,000 |
| Gross amount realized on resale | $20,000 | |
| Less expenses of resale | 2,000 | |
| Net amount realized on resale | | 18,000 |
| Net loss | | $12,000 |
| The insurance company is responsible for ¾ of such net loss or | | $9,000 |

(*b*) The assumption of an agreed portion up to two-thirds of the net loss is found in the general policy where the whole turnover is insured against ultimate loss.[8] In this case the insured must bear at least one-third of the net loss, the higher percentage being used so that he will take good care in the extension of credits, the company being liable on each and every bad account since it is not issuing a "declaring" policy. This is the only way to minimize the moral hazard.

There may be some cases where the insured has borne a part of the loss because of the fact that he has extended an excess

[8] See Appendix VI.

over the single account limit mentioned in the policy. In order to ascertain the amount on which the insurance company's agreed percentage will have to be calculated, it is necessary to deduct any salvage which is obtained, in the proportion that the amount uninsured bears to the total of the credit. To illustrate what is meant in this case, it may be assumed that the insurance policy promises indemnity for one-half of the amount of a net loss that the insured has sustained. Assume also that the policy has a single account limit of $20,000. Suppose now that the insured grants a credit of $50,000 and subsequently payment is defaulted because of insolvency as defined in the policy. The salvage as ascertained at the time of discharge from bankruptcy is 20 per cent or in this case $10,000. Since the insured had absolutely no protection on three-fifths of the amount of the credit he is entitled to three-fifths of the amount of the salvage or $6,000 on $30,000 of the credit. Now since the company agrees to pay one-half of the ultimate net loss of the remaining $20,000, $4,000 or the balance of the salvage will be deducted from the $20,000, leaving $16,000 as the ultimate net loss of which the insurance company agrees to pay one-half or $8,000. Thus on a policy with the conditions as assumed, the insured collects only the sum of $8,000 from the insurance company, and he collects $10,000 as a dividend from the bankrupt's estate or a total of $18,000 on a credit of $50,000.

(*c*) Excess loss[9]: In order to calculate the amount of the loss for which the insurance company is liable under an excess loss policy, the insured first will have to deduct from each individual loss that he has sustained an agreed percentage which he bears himself. The remainders obtained in each case are then totaled. This total is then compared with the so-called "first loss" which is also to be borne by the insured, and said "first loss" is calculated by taking the agreed percentage of the actual sales which were protected under the policy during the stipulated period. If the total of the losses as ascertained by deducting the percentage of each credit borne by the insured exceeds the "first loss," the insurance company is liable for the difference.

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[9] See Appendices VII and VIII.

The latter may further be subject to a maximum total liability as specified in the policy.

Let us assume that the insured agrees to bear 10 per cent of each and every loss and also a first loss of ¼ of 1 per cent on his gross sales turnover within the policy period. Further assume that he has a sales turnover of $4,000,000 on which he sustains credit losses of $15,000 on customer "A" and $10,000 on customer "B." The liability of the insurance company will then be determined as follows:

| | | |
|---|---|---|
| Loss on A's account | $15,000 | |
| Less insured's share 10 per cent | 1,500 | |
| | | $13,500 |
| Loss on B's account | $10,000 | |
| Less insured's share 10 per cent | 1,000 | |
| | | $9,000 |
| Total to which "first loss" is applied | | $22,500 |
| First loss: ¼ of 1 per cent of sales or | | 10,000 |
| Amount for which insurance company is liable | | $12,500 |

After proof of loss has been submitted, the company is obliged to pay the claim within one calendar month, the insured being allowed sixty days after the expiration of the policy in which to file his proof of loss.

**Methods used to facilitate adjustments.**—It will be observed that some policies promise to indemnify against ultimate net loss and since this may not be ascertained for a period of several years, the payment might be indefinitely delayed even though it was a practical certainty that loss would occur. At times the practice is to settle at the end of nine months after default of payment, but the policies make no such promises and the insured merely takes a chance on the company's attitude. However, a provision is sometimes inserted whereby the ultimate net loss is determined in an arbitrary manner.[10] For illustration, one policy provides that if the outcome has not been ascertained and is not ascertainable within one month from the date of the expiration of the policy, or if the dividend paid or declared does not exceed 15 per cent of the debt but further

[10] See Appendix VIII.

dividend is expected, then the loss shall be estimated upon the basis that the estate will produce 25 per cent. If an amount exceeding 15 per cent has been paid and further dividend is expected, then 12½ per cent shall be added as the estimated amount that will be realized in further dividends. It has the advantage of immediate rather than the deferred payment incident to the ascertainment of the so-called ultimate loss, which may take several years.

Another method used is to insert an arbitration clause. The English policies frequently state that any dispute about the policy, or any claim arising under it, is to be settled according to the English Arbitration Act of 1889, or its amendments.[11] Each party must bear his own cost of the reference, and a moiety of the cost of the award and of the arbitrator. For some reason Americans do not avail themselves of arbitration as a method of settling disputes although a policy formerly issued, covering rejection, provided for settlement of disputes by arbitration where loss was alleged to be caused by failure of the insured to live up to the terms of his sale contract.[12]

**Subrogation.**—The usual condition regarding subrogation in insurance policies is likewise found in credit insurance, *i. e.*, the insurance company is subrogated to the extent of any payment it makes to the insured. It is also required that the insured shall file a claim with a bankruptcy referee, receiver, assignee, or other proper officer so that the insurance companies' rights will be adequately protected. If the insured is negligent about taking any such necessary action, and thus destroys the rights to which the insurance company would have been subrogated, the insurance company will deny any liability. This does not mean that the company assumes no liability if the insured does not have opportunity to file such claims because of distance, abnormal circumstance, and the like, but applies to those instances where he is negligent in so doing.

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[11] See Appendices V, VII and IX.

[12] The Associated Exporters.

## Chapter IX

## REINSURANCE

**The need for reinsurance.**—The direct writing companies are not large enough to assume single account risks of high amounts. It is necessary, therefore, to obtain reinsurance on those risks which involve a catastrophe hazard. It is known, for instance, that some of the worst losses that have ever occurred in connection with credit extensions are the failures of merchants of the highest standing. When such a failure occurs, the outstanding liabilities are not only absolutely larger, but frequently relatively larger in proportion to assets than in the case of small concerns. This is due to the fact that confidence is greater in the case of the large reputable firms, and the persons who grant credit have a tendency to be much more lax than in those cases where there is doubt. Consequently, if the credit extensions to a large house are to be insured, there is quite likely to be an exceedingly large amount at risk which may be lost by a single act. For illustration, many big firms have outstanding indebtedness of from $500,000 to $1,000,000. If any of the direct writing companies would assume such a risk, a 100-per-cent failure of such an account would most likely be disastrous to them. In fact, none of them at the present time will normally assume more than $400,000 of insurance on a single account, and this sum only because of their ability to reinsure the major part. Even the companies which assume the reinsurance liability do not have a large enough distribution on credit insurance completely to eliminate a catastrophe hazard. Their assumption of this risk is possible only because of reinsurance with other reinsurers, and the distribution of the credit reinsurance risk along with that of other lines.

**Types of reinsurance contracts.**[1]—It may be necessary

[1] The types of reinsurance contracts hereinafter mentioned and the specific percentages which are given in the reinsurance illustrations are taken from a circular letter issued on March 15, 1923, by the American Manufacturers' Foreign Credit Insurance Exchange.

to have more than one reinsurance contract because the existing reinsurers will not assume all of the risk which the direct writing company desires to transfer. However, the contracts are all of the excess variety and are applied to the single accounts. To indicate more clearly the nature of these different excess loss reinsurance policies, they may be divided into two groups.

1. Those which assume all excess loss on a single account when the loss exceeds a certain specified sum. This specified sum is usually relatively small. Thus the reinsurance company may assume all excess loss on an individual buyer, if it exceeds $1,000, $1,500 or $2,000. The writer does not know of any case where the direct writing company assumes the entire loss in excess of $2,000, although there are cases where the direct writing company participates in the loss exceeding this sum. In every case there is an upper limit to the reinsurer's liability as well as a lower. No illustration is known where this upper limit exceeds $400,000, excepting in special cases which are arranged from time to time "for the account of London Underwriters," on shipments of specific commodities to certain approved buyers. It should be mentioned, however, that in these latter instances only a fraction of the loss, such as 75 per cent, is assumed.

2. A second type of excess loss reinsurance policy is that in which the direct writing company participates with the reinsurance company on all losses exceeding certain amounts, and up to certain limits, on individual buyers. This share excess is arranged on a percentage basis so that if a loss exceeds a specified sum, the direct writing company assumes a given percentage and the reinsurers the balance up to a maximum limit. It is this upper limit which fixes the direct writing company's maximum insurable line on a single buyer.

**Illustration of reinsurance.**—The arrangements of the largest direct writing company involve absolute excess and also excess share reinsurance. These contracts are divided among several companies and are as follows: Reinsurer "A"[2] assumes

[2] The Employers' Indemnity Corporation of Kansas City.

(1) 70 per cent of the liability in excess of $1,000 and not exceeding $25,000, and (2) 14 per cent of the amount of a loss over $125,000. Reinsurer "B"[3] assumes (1) 100 per cent of the loss between $25,000 and $125,000, and (2) 80 per cent of the loss from $125,000 to $400,000.

Assuming a loss of $250,000 on a single buyer, it would be divided as follows:

| | | |
|---|---|---|
| *Reinsurer A* | | |
| 70 per cent of the amount between $1,000 and $25,000 or 70 per cent of $24,000 | $16,800 | |
| 14 per cent of loss in excess of $125,000 or 14 per cent of $125,000 | 17,500 | |
| Share of Reinsurer A | | $34,300 |
| *Reinsurer B* | | |
| 100 per cent of the amount between $25,000 and $125,000 | $100,000 | |
| 80 per cent of loss in excess of $125,000 or 80 per cent of $125,000 | 100,000 | |
| Share of Reinsurer B | | $200,000 |
| *Direct Writing Company* | | |
| The first | $1,000 | |
| 30 per cent of the amount between $1,000 and $25,000 or 30 per cent of $24,000 | 7,200 | |
| 6 Per cent of loss in excess of $125,000 or 6 per cent of $125,000 | 7,500 | |
| Share of Direct Writing Company | | $15,700 |
| TOTAL | | $250,000 |

**Miscellaneous provisions of a reinsurance contract.**— In addition to the amount of liability assumed by the reinsurer it is necessary to have an agreement concerning the events for which he is liable, and the duties and obligations imposed on both parties to the contract.

The most important thing is the type of loss for which he will be responsible. Usually this is in accordance with the terms, conditions, and limitations of the policy issued by the direct writing company, but it is customary to recite in detail the definitions of such things as "insolvency."

[3] English Underwriters.

Other provisions consist of statements which indicate:

1. The method of informing the reinsurer of the risks written and the amount of liability assumed.
2. The method of computing and the time of payment of the reinsurance premium.
3. The right of the reinsurer to participate in the settlement of a claim.
4. The right of the reinsurer to information on the subject matter insured.
5. The time when payment for loss is due from the reinsurer.
6. The right of the reinsurer to salvage.
7. The privilege and method of cancellation.

## Chapter X

## THE FUTURE OF FOREIGN CREDIT INSURANCE[1]

To one who has become enthusiastic over the services, both actual and potential, which foreign-credit insurance can render, its future appears quite brilliant. Although the advantages of this form of insurance have made themselves evident in some of the preceding chapters, no space has been devoted to a general summary of them prior to this point. However, the various operating details of the credit insurance now issued have been explained and a consolidation of the advantages may be timely. It will be recalled that in the first chapter the American methods of export were divided into "direct" and "indirect," and since the advantages of credit insurance are not exactly the same for both of these methods, a separate presentation will be given for each.

**Advantages of credit insurance to the direct exporter.** —Those who use the direct method include many of the small and occasional exporters of manufactured articles. To conduct such a business, each direct exporter must maintain his own organization for ascertaining markets, investigating the credit risks to whom merchandise is offered, and obtaining the orders. Such operations are costly and frequently prevent manufacturers from entering the export trade. To increase the difficulties he must meet competition and the exporters of other nations see to it that this is very keen in manufactured goods. Even if the quality and price of the other seller are met, there remain the terms of credit which must be equalled or bettered.

[1] It should be called to the attention of the reader that the statements contained in this treatise are not to be confused with the future of America's shipping or export trade. It is true that shipping in American bottoms has been declining, but a large export trade has been carried in foreign vessels before this time. Insofar as the export trade itself is concerned there are conflicting opinions, although it might be mentioned that recent figures show an increase. But even if the improbable should happen and the export trade of the United States were reduced to nil the principles of foreign credit insurance as set forth could be applied to any nation with an export business.

Most of these problems are solved by foreign credit insurance as practiced by the mutual type of company, *i. e.*: (1) It furnishes the exporter with a pre-analyzed and picked market where he can proceed to solicit business; (2) it supplies him with credit information on the foreign buyers, and (3) it guarantees his credit extensions within certain limitations and requirements.

These services enable him to grant safely the same credit terms offered by his competitors. This is particularly true of open accounts or long-time credits. They also make him more willing to finance on the basis of trade acceptances or revocable bank credits; all of which tend to make it easier for him to conduct an export business.

**Advantages of credit insurance to the indirect exporter.**—Indirect exporting, it will be recalled, included the export commission house, the export merchant, and the manufacturer's agent. These middlemen virtually amount to insurance companies because they assume credit risk. This is always true of the export merchant who buys and sells on his own account and must settle for the merchandise irrespective of the foreign buyer.

In practice, about the same can be said of the commission house, because it may buy on an f.o.b. basis and quote c.i.f. to the foreign buyer; and besides, it ordinarily settles with the American seller before it receives payment from the buyer.

By means of insurance, these middlemen can transfer the credit risk which is incidental to their transactions. It is quite true that credit insurance is not so necessary for the indirect exporters as for the direct because the former are frequently large enough to have a fairly wide distribution of credit risks. Nevertheless, they are frequently prevented from taking very large orders on single accounts because of the volume of credit needed. Therefore, credit insurance on these large shipments greatly facilitates their business. It should be mentioned that these middlemen ordinarily will object to going into a mutual that requires interchange of ledger experience, for fear some of their valuable trade information might be revealed. Consequently, the only insurance that is available to those who object is that of the fractional type.

**Criticisms of credit insurance.**—In spite of the distinctly great advantages of credit insurance to the different exporters, certain objections have been raised. The most important of these are:

1. The expense of an insurance premium places an additional burden on export business.
2. "Insolvency," as defined in the various policies, does not cover many of the most serious credit losses.
3. The companies have failed to include "rejection of goods" in the protection which they offer.
4. It is undesirable from the standpoint of individual exporters to disclose credit information which they have compiled.
5. A great part of the protection is for individual shipments only, and it is not known whether the account can be insured until inquiry is made.
6. The total insurable line on individual buyers is frequently unreasonably low.
7. In some cases full or 100-per-cent protection is not given; instead the insurer pays only 50 to 75 per cent of a loss.
8. There is a lack of stock companies in the field. The reciprocal which appears to be the most successful type of organization in this line is not favored by many exporters because of the assessment feature and the powers given to an attorney-in-fact.

The majority of these criticisms have been met or are capable of solution. Let us turn, therefore, to an examination of the manner in which these objections are answered.

1. *The cost of credit insurance.*—By reference to the chapter on "The Premium" it will be observed that the amount charged is really very low. The foremost company is charging 1 per cent, 1⅛ per cent, and 1¼ per cent for a period of sixty days, depending on the credit rating of the account in question. This seems to be adequate because its losses for the year 1922 average considerably below 1 per cent. In another case where rejection has been covered, as well as insolvency, the rates have not been more than twice the rate given above for similar credit ratings. If these rates are adequate, and it is claimed they are,

the criticism of excessive rates is absolutely invalid. When one considers that the banks in the past have been charging an amount greatly in excess of this, merely for collection purposes where no guarantee of any kind is given, it would seem that most exporters should be willing to pay this small insurance premium in order to assure themselves that the debt or a substantial part thereof, would be paid.

2. *The insurance of insolvency only.*—Only one company has attempted to insure anything other than the event of insolvency and that company is not writing any business at the present time. Therefore, the present facilities do not meet the requirements of the exporters who desire a type of insurance which makes them absolutely certain that once a contract of sale has been made, there can be no doubt about the fulfillment of the terms of that contract on the part of the buyer. They grant that insolvency is one of the things which may cause the buyer to default. They claim, however, that this is not the major cause of their worry. They further maintain that even if it were the most important source of loss, an insurance company could help them but little because the insurance company is going to dictate to the insured as to what accounts it will accept for purposes of insurance protection. Inasmuch as most credit insurance is on a unit basis, the insurance company is always in a position where it can refuse to insure just those particular accounts concerning which the exporter may have some doubt. In other words, the exporter says that the only time the insurance company will accept a risk is when he is willing to run the same chance himself. It may be likened, he says, to a fire insurance company that refuses all risks excepting those which are fireproof. There is, perhaps, some truth in this claim because certainly credit insurance companies that cover only in case of insolvency do not amount to distributors of risk in the same manner that fire insurance companies do. The insurance company's answer to this accusation is that they cannot assume a risk where they are virtually sure a loss is going to occur, or to reply to the exporter's analogy, a fire insurance company would not be apt to place a policy on a burning building. Therefore, they are distributers of the

risk of loss only in case the one named event occurs, and do not pose as insurers of the account under all circumstances. They further point out that there are plenty of other types of insurance where certain causes of loss are very serious and yet the particular type of policy that has been issued does not cover them.

3. *Insurance of rejection.*—This leads to the question of insurance of the commercial risk which includes rejection of merchandise and repudiation of the sales contract. Although not identical, the relationship of these is very close and they are subject to the same general hazards. Repudiation may involve a greater number of losses but if it occurs before the exporter has incurred a great amount of expense, it is not as serious as when the importer rejects goods at the time of arrival. Repudiation has the further advantage of giving rise to a more clean-cut type of loss. That is, the buyer merely cancels because he does not want the merchandise for some reason. If this is done to any extent, the importer soon acquires a bad reputation, and therefore, he will use great discretion, repudiating only as a last resort. But rejection can be more gracefully accomplished by claiming that damage in transit, partial shipment, late delivery, or some such physical reason is the cause for rejection. Consequently, there is greater agitation for the solution of this problem.

It is quite natural that insurance against rejection of merchandise should seem very desirable from the standpoint of an exporter, because he would be relieved of all worry as soon as he had made a shipment. However, it is fraught with many grave dangers which are not evident upon first consideration.

Ordinarily, when thinking of rejection, one has a tendency to put the blame entirely on the party refusing to accept the merchandise. Unquestionably this is usually the case and it is such instances which need insurance protection. But right here a great moral hazard enters which is very difficult to estimate. For example, there may be collusion between the buyer and seller to force the merchandise on the insurance company. Even though the insurer becomes aware of this, how is he going to prove it? Another danger which is even more real than the former is the laxity with which the exporter may fill orders,

resting securely in the knowledge that either the importer or the insurance company will have to pay.

The problem then consists mainly in solving the moral hazard of rejection, and arbitrating disputes. This can be accomplished only by refusing to insure any accounts involving dishonest buyers and sellers. But how is an insurance company to distinguish between the honest and the dishonest? This can be done only through the most accurate kind of system of gathering credit information. It involves not only historical credit data, but a system of interchange of ledger experience which answers the following on every export shipment made:

(1) Was the shipment satisfactory?
(2) Was delivery late?
(3) If rejected was it without justifiable cause?
(4) Was there a claim for shortage?
(5) Did the importer dishonor the draft?
(6) If the sales contract was repudiated what was the cause?
(7 )Was there a claim for damage in transit? (*a*) If so, was the packing faulty?
(8) Was there a claim for inferior quality?
(9) Were the shipping instructions obeyed?

The only way to get this information is to make it obligatory upon the insured to report the details of each shipment to the insurance company. Incidentally, the unit shipment method of insurance is a great aid to this objective because the submission of the data is automatic. Having obtained this information, the method of compilation must be under code numbers in a manner similar to that described in connection with the "Sources of Credit Information." Then, from the records it will be possible to trace the actions of both exporters and importers, and the dishonest of both groups can be sifted out. Too much emphasis cannot be laid upon the importance of the care with which this information must be compiled, because the very fact that the exporter knows the insurance company will blacklist the importer who does not live up to his agreement, may lead an unscrupulous merchant to ship inferior commodities to the importer and force an unfair settlement by threatening to report him to

the credit bureau of the insurance company. Therefore, this may be considered as the key to the whole situation, as it must reveal completely the character of the methods of both the exporters and the importers, and in cases where doubt arises, the benefit must be given to the one with the best record. Of course, when a situation arises during periods of a business cycle when prices are rapidly declining and cancellation occurs on a large scale, these records which normally would be used to determine who was at fault would be of little use. The only solution to this is to build up big reserves during the prosperous years, in a manner similar to that practiced in unemployment insurance and domestic-credit insurance.

No doubt, the possibility of covering rejections is more nearly approached if combined with marine insurance. By this is meant that the marine insurance should be issued along with the credit-insurance policy through some central office which maintains supervision over the condition of the shipment at various stages of its journey. This would then enable the credit insurance company to know more accurately the condition of the merchandise at the time of arrival, and the reason for rejection, because the representatives of the marine insurance company would necessarily have to know about the loss or damage which the shipment had sustained before it would pay a claim. Many times rejection occurs because only a part of the shipment arrives, the balance having been lost in transit. At other times refusal to accept is due to the condition of the shipment because of damage that has occurred to it since leaving the hands of the exporter. Obviously these situations call for marine insurance protection to the extent of the loss or damage affecting the particular shipment and then, if further loss is sustained because of rejection, it is possible for the credit insurance company to indemnify.

This does not mean that rejection in all its forms can be covered, but that all situations, except those involving trade disputes, quality, and the like, can be protected. It might even be possible to include trade disputes if some clause was to be placed in the policy providing for the settlement of these disputes according to the term of some specified arbitration act,

such as the English Act of 1889. It would have a force similar to that found in the appraisal clause of the Standard Fire Policy in common use at the present time. However, this will not be a success until the legality of such clauses is more universally recognized. England is the only foreign country, and New York is the only state of the United States, which has progressed very far along this line. An international arbitration law that in all probability will meet ultimate success has been proposed, but it will take time to come into general use.

For the purpose of insuring rejection and other causes of loss, one progressive underwriter has made a proposal for a mutual exchange that contains great possibilities. Briefly stated, he would permit the exporter to manufacture his commodity, find a buyer, and make a contract with him. Then, after preparing his export documents, he would turn the entire contract over to the insurance company and it would guarantee payment within a specified period of time, regardless of cause of loss not the fault of the exporter. The comprehensiveness of a scheme of this kind can scarcely be realized without an examination of the details involved. An enumeration of some of the risks assumed by this guarantee gives an indication of the extent of the plan. They are the risks of loss:

(1) Due to fire.
(2) Arising out of marine perils.
(3) From fluctuation in foreign exchange rates.
(4) Due to insolvency.
(5) From repudiation.
(6) Through rejection.

To facilitate matters, the guarantee company would transfer all the risks except those pertaining to credit, the premium paid by the insured being adjusted in accordance with the costs of the other types of protection. The guarantee company would still be directly liable to the insured, but the latter would know that the proper kind of insurance on physical hazards had been obtained, thus eliminating the liability of the former because of some contingency ordinarily assumed by marine or fire insurance. The guarantee would also hedge against fluctuating foreign exchange rates in the foreign exchange future market. In order

to do the latter successfully, it would be necessary for the insured to notify the exchange as soon as the contract was made because it is impossible to make such a guarantee without the opportunity to sell a foreign exchange future before any fluctuation in quotations has taken place. This is possibly the greatest combination of diverse types of insurance that has ever been proposed. It is well known that each of these various facilities exists, but few persons have ever thought of jointly utilizing them by a method such as the one just described. Even if this plan is not actually put into operation, it at least shows some of the wonderful possibilities that exist for multiple-line insurance. It also serves to point out another analogy which many persons fail to observe, namely, that dealing in futures constitutes a kind of insurance.

The remaining risks which are connected with credit would be assumed by the exchange. This requires the maintenance of very accurate and complete credit files on foreign buyers and extensive commercial information. In addition to the credit information previously described, the underwriter must also have a knowledge of (1) world-wide prices, (2) the margin of profit usually found in a given commodity, (3) the types of commodities absorbed in given markets, including local and peculiar desires concerning them, (4) the volume of purchases that a buyer is customarily able to dispose of within a reasonable period of time, and (5) the extent of a buyer's recent purchases.

In order to gather this information, it would be necessary to maintain representatives in the different ports of the world to which shipments are likely to be made. It would also be necessary to maintain legal offices and to provide facilities for salvage. The former is for the purpose of filing claims and prosecuting them within the legally allotted time, and the latter advantageously to dispose of goods rejected for some cause or other.

For this purpose the insurance exchange would use the foreign offices, the marine agents, surveyors, and adjusters, of the affiliated marine companies already located at the important points of shipment and discharge. This would have the twofold advantage of reducing expenses and enabling the credit insurance company to get more accurate information on causes

of losses through rejection. While this proposal has been termed "visionary" and appears unlikely of accomplishment to some underwriters, it should be called to mind that practically every type of insurance and every form of coverage ever suggested has in its early stages been received with incredulity and jeers, and pronounced impossible.

4. *The difficulty of getting credit information.*—It is quite true that many difficulties are encountered in getting credit information on foreign buyers. A good deal of this is due to the reluctance with which foreigners supply such information, very few countries having developed in this respect to the extent of the United States. The inadequacies of the regular sources of information have already been described. It would appear that the only solution is to get the missing information from the people who do the trading, in other words, obtain it through interchange of ledger experience. The objection to this is that an exporter does not like to go through many years of experience, learning at great expense that customers "A," "B" and "C" are excellent pay, and customers "X," "Y," and "Z" are very poor credit risks, and having paid the price for this information, turn it over to an insurance company free of charge so that his competitors may get the benefit of it. This, however, is a very narrow and short-sighted view to take because it is the co-operation of the many that will result in good for all. If an exporter is so inefficient that he cannot meet his competitors' terms, it means that he should be driven out of business, as he is merely holding his position because of some monopoly, privilege, or power. Therefore, if he has the interests of all exporters at heart and is not afraid to meet competition, there is no good reason why he should not be willing to permit the pooling of the data that he possesses, so that other people may benefit; and he, likewise, will obtain the benefit of that information which others have acquired.

5. *The insurance of individual shipments.*—Most of the insurance covering foreign credits is for individual shipments. In some cases it has been elective on the part of the insured whether or not he should submit a certain shipment for coverage. More objections can be raised against this from the standpoint

of the insurance company than from that of the insured. Wherever the insured is to have the option as to whether or not a specific customer should be covered with insurance, there is very likely to be an adverse selection against the insurance company because the insured, if he happens to have some information of the customer, not possessed by the insurance company, may withhold it and insure the risk, while in those cases where he is practically certain that the account is satisfactory he will not bother to secure coverage. However, an argument based on the experience of domestic credit insurance companies might be given against such action. It is claimed that the largest losses have occurred on the so-called best risks. Nevertheless, there remains this possible adverse selection, which can be overcome by a policy compelling all accounts to be submitted for insurance. Better still is a policy providing mass coverage for all accounts falling within certain designated credit limitations. One company has offered this latter type of policy, but it is fractional protection. In the case of the policies giving 100-per-cent coverage, it is not yet practicable to have the insured submit every case because the insurer must turn down a large percentage of the proposed risks on account of lack of sufficient credit information. Mass coverage, principally of the excess loss type, has been issued with great care and rigid requirements for the same reason. However, when credit guides covering all of the world's most important buyers have been compiled, it seems as though almost any policy desired will be issued.

6. *The limit to the total insurable line.*—The limit on a single account at the present time is rather low, the maximum being $400,000 for the highest rated risk, except in a few rare cases. This is really due to the inadequacy of re-insurance facilities for foreign credit insurance companies and does not imply that the buyer is not frequently worthy of greater credit extension. When this type of insurance becomes better known and more credit information is available, there will be more companies willing to re-insure, and the present maximum amount undoubtedly will be increased.

7. *Fractional coverage only.*—As far as unit coverage is con-

cerned, 100-per-cent protection is being given under the mutual company policies. However, there is a great advantage in making a merchant a co-insurer on every loss because it induces him to use more care in credit granting and reduces the moral hazard. Under a policy affording mass coverage, it is customary to give only fractional coverage. In fact, the exporters asking for full coverage on such policies display lack of appreciation of the "deductible" principle used in insurance. It is well known that every type of business has a normal loss ratio from bad debts. This, of course, varies with the different businesses, but it always exists and should be considered the same as any other operating expense. If this loss is to be borne by the insurance company, it not only must collect sufficient premium to meet this customary loss, but the overhead expense of administering it in addition. Therefore, the insured is better off if he bears the loss in the first place.

8. *Lack of stock companies.*—The most successful type of company in the field of foreign credit insurance has been that organized on the reciprocal mutual basis. It has been claimed by many of those interested in the subject that it is the only method feasible because of the necessity for interchange of ledger experience, which cannot be made a compulsory and automatic thing, except through a reciprocal mutual. The objection to this, advanced by some exporters, is that the reciprocal mutual insurance companies have not proved very satisfactory because of the power given to an attorney-in-fact, and also because of the contingent liability that exists in these companies through the privilege of assessment. The demand, therefore, is that stock companies should supply the insurance desired. Undoubtedly, after the proper information has been made available for predicating rates, there will be stock companies that will meet this demand. In fact, if the principal advantage of the mutual consists in the ability to obtain and centralize credit information, the obstacle is not by any means insurmountable. The compilation of the information can be attained through an agreement such as the one used by the Foreign Credit Interchange Bureau of the National Association of Credit Men. The centralization of information for the pur-

pose of predicating rates can be accomplished by the creation of a rating bureau to be maintained by all the interested companies, and similar to those used in other lines of insurance, such as Accident and Health, or Workmen's Compensation.

There is at present, however, a factor which tends to discourage existing stock insurance companies from entering the field. The problem involves the interrelation of marine insurance and bonding, but the laws do not permit the combining of the two lines in the ordinary stock or mutual company. This explains the proposal previously cited for a "mutual exchange" which would "guarantee payment" to an exporter. In this organization the emphasis would be laid on the word "guarantee" and the term "insurance" would be omitted. Several insurance commissioners who have been approached on this matter say that such an organization is not under their supervision and they have no right to interfere with the rights of private citizens in exchanging contracts of mutual guarantee. This most certainly is not a very desirable situation, and could easily be solved if multiple line insurance laws were passed permitting the ordinary type of company to issue combined coverage.

**Advantages to the export trade.**—The advantages which foreign credit insurance possesses for the different types of exporters have already been mentioned. Its useful future, however, depends on its ability to aid the export business as a whole. This it has the power to do in many ways, and a general summary of these services follows: (1) The prevention of loss; (2) the elimination of the abuses of the exporters; (3) the establishment of more uniformity in export practices; (4) the reduction of wasted effort, and (5) the facilitation of foreign trade financing.

1. *The prevention of loss.*—As in most types of insurance prevention of loss is one of the greatest functions. This is accomplished by:

(*a*) The elimination of the dishonest foreign buyers. The information compiled on the buyers, as previously described, will reveal sufficient facts to be used as a basis for exclusion from insurance protection. The mere fact that a buyer has been rated as uninsurable will cause exporters to avoid him.

(*b*) Arbitration of disputes. As soon as there is general legal

enforcement of arbitration clauses, it will be possible to settle disputes arising out of rejection and repudiation at a very small cost to both parties. Insurers of credit naturally are much interested and are in an ideal position to aid in the development of such a condition. When it is adopted it will minimize one of the most uncertain and unpleasant hazards in the export business.

(*c*) Moral suasion. Whenever a debtor becomes dilatory, a letter from the creditor stating that he will report him to the credit bureau may get prompt action. The debtor realizes that adverse information will affect his credit status and may injure his opportunities for further favorable contracts. However, if such letters from the exporter fail to obtain remittance, the credit bureau of the insurance company itself may be able to get better results. It is to be hoped that this instrument will be used judiciously by both the creditor and the credit bureau; otherwise exporters may use the "publicity threat" in order to force payment when they themselves have been deficient in complying with the terms of the contract.

(*d*) The collection of past due debts. There is very little difference between this advantage and the one pertaining to moral suasion. However, the facilities necessary to the operation of the insurance company which are maintained abroad can be used as a local agency to collect overdue debts on uninsured as well as insured accounts.

(*e*) Salvaging when a loss has occurred. It is impracticable for each exporter to maintain a representative in every district where he ships merchandise and consequently he is not in a position to obtain the facts when a credit loss occurs. Furthermore, most exporters cannot be supposed to be posted on the legal procedure of all nations and as a result they must hire expensive legal talent if they wish their interests protected. A credit insurance company can take care of this problem very well. Offices located at all of the principal trading points of the world can attend to the various cases for all of the insurance company's clients. This is advantageous to the insurance company as well as the insured, because the company is in a position to minimize its own losses by refusing to compromise claims on unsatisfactory terms.

2. *The abuses of the exporters can be reduced very materially.*—It will be recalled that the method of compiling information on the actions of foreign buyers in regard to certain shipments also reveals the deficiencies of the exporters. Bad packing, shortage, inferior merchandise, late delivery, and disregard of shipping instructions are some of the present abuses. When an exporter is found to indulge in such practices, he will be refused insurance protection. In fact this is a reversal of the situation which prevails when a foreign buyer is guilty of abusive methods, *i. e.*, the foreign buyers will not wish to deal with an exporter if the insurance company discloses his actions.

3. *Uniform export practices can be increased.*—A standardization of policies will lead to more uniformity in methods of quoting prices. It is also expected that more uniform and better packing will exist and this will lead to greater uniformity in marine insurance protection and lower rates.

4. *Wasted and duplicated effort can be reduced through the information compiled by a foreign credit insurance company.*—In order to assume the risk of foreign credits, the insurance company must know: (1) The markets and their needs, and (2) the credit status of the buyers. The first involves a knowledge of the kinds of commodities, down to the minutest detail, which are absorbed in the different markets. This information can save the exporter much time and money in ascertaining the requirements of foreign buyers.

The second includes historical credit data and interchange of ledger experience. As pointed out in a previous chapter, there are many ways of obtaining credit information and the duplication of effort is enormous. Centralization of this information by credit insurance companies will greatly reduce this useless waste.

5. *Foreign trade financing may be facilitated by credit insurance.*—The knowledge that a credit insurance company will pay if the buyer fails enables an exporter to quote whatever credit terms are necessary to secure the order. The facilities for long-term financing have been in existence for some time, but the exporter has had to bear the burden of the credit risk. Credit insurance now relieves him of that. Furthermore, it is

not unlikely that a stage may soon be reached where the banks will discount without the right of recourse because of the guarantee of a credit insurance company.

**Conclusion.**—In view of all the services which it is possible for credit insurance companies to render, it is surprising that credit insurance has been neglected for so long a time. Undoubtedly, the lack of it has kept many merchants out of the export trade. However, through the development of the facilities which have been described, the great mass of potential exporters can safely enter the trade that has been called the greatest stabilizer of all business.

## Appendix I

### SUBSCRIBER'S APPLICATION AND CONTRACT

AT THE

### AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE

Chicago, Ill.

We, the undersigned, hereby make application for membership in the American Manufacturers' Foreign Credit Insurance Exchange and for Master Policy of Foreign Credit Insurance issued at said Exchange, which form with its stipulations, statements and warranties are agreed to by us and we further agree that the final ratings of the AMERICAN MANUFACTURERS' FOREIGN CREDIT UNDERWRITERS, Inc., shall govern exclusively all shipments under said Master Policy of FOREIGN CREDIT INSURANCE.

NAME.....
ADDRESS.....
BUSINESS CLASSIFICATION.....
ESTABLISHED.....
USUAL TERMS OF FOREIGN SALES.....
APPROXIMATE AVERAGE YEARLY EXPORT SALES.....

Our membership in the AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE is under the following designated annual basis.....
.....

It is mutually agreed that the guides issued yearly are for our own use exclusively and that the same will not be sold, rented, loaned or given to any other person, firm, corporation or organization; such guides to remain the property of the American Manufacturers' Foreign Credit Underwriters, Inc.

*Know all men by these presents, Whereas,* The undersigned hereby designated a SUBSCRIBER desires to secure protection against loss due to the insolvency of foreign debtors resulting from the SUBSCRIBER'S bonafide sales, resales, consignments or shipments of merchandise, by the exchanging of private contracts by and through the American Manufacturers' Foreign Credit Underwriters, Inc., as Manager and Attorney-in-fact for the American Manufacturers' Foreign Credit Insurance Exchange.

*Now, therefore*, We, the undersigned, as a SUBSCRIBER at the AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE, hereby appoint the AMERICAN MANUFACTURERS' FOREIGN CREDIT UNDERWRITERS, INC., a corporation, our Attorney for us in its name as our Attorney, and in our place and stead to make, subscribe, issue, change, modify, reinsure or cancel contracts exchanging foreign credit insurance and/or insurance and indemnity and agreements for such exchange of contracts, containing such terms, clauses, stipulations, statements and warranties, as it shall deem best: *Provided, however*, That the insurance and indemnity exchanged for us shall be in the proportion which our earned premium during any fiscal year of the Exchange, as the same may be fixed and changed from time to time by the Exchange, bears to the total earned premium of the Exchange for such fiscal year and that the total of such insurance and indemnity exchanged for us, together with taxes, department fees, adjuster's and attorney's fees, court costs and all other expenses of any kind, shall in no event render us liable for more than once again our earned premium during any such fiscal year of the Exchange; earned premium as herein used shall mean the premium charged for insuring foreign credits of members arising from specific shipments of merchandise, to demand, collect, receive, and receipt for all moneys due us for credit to our account as a SUBSCRIBER; to give, waive or receive all notices or proofs of loss; to adjust and settle all losses and claims on such contracts or other evidences of indemnity; to perform or waive all agreements or stipulations of any such contracts; to appoint the Insurance Superintendent or like official of any state, or in lieu thereof a duly accredited agent, as our agent, upon whom service of process may be made with the same force and effect as if made upon ourselves; but only in relation to any foreign contract or claim hereby authorized; to appear for us in any suits, actions or proceedings and bring, prosecute, defend, compromise, settle or adjust same; to perform every act not herein specifically mentioned that we could ourselves do in relation to any foreign sale or contract hereby authorized.

Our Attorney shall automatically renew all negotiable foreign credit insurance certificates at the prescribed renewal premium rates until instructed in writing by the SUBSCRIBER that further renewals are not required; subject to conditions and limitations contained in the policy; renewal premiums to be charged to SUBSCRIBER'S premium account at the Exchange.

We hereby agree to furnish our ledger and sales experience on any foreign buyer and a synopsis of credit information in our possession upon any specific buyer when called upon by the Exchange so to do; said ledger and sales experience and credit information and its source to be for the confidential use of the Manager and Attorney-in-Fact.

A Board of Trustees consisting of not less than seven SUBSCRIBERS or their representatives, of which four shall constitute a quorum for the transaction of business, shall be elected to serve for one year at the annual meeting of SUBSCRIBERS, of which the Attorney shall give each SUBSCRIBER at least ten days' notice in writing and which shall be held on the second Tuesday of January of each year; voting to be by ballot, each SUBSCRIBER or his proxy having one vote, vacancies on the Board of Trustees may be filled by the remaining members or our Attorney.

There shall be no joint funds, but a separate individual account shall be kept by our Attorney with us and with each SUBSCRIBER; said account to be open to our inspection. Our Attorney shall provide for the safe keeping of SUBSCRIBER'S funds. If at any time losses occur impairing the reserve on policies required by law to be maintained, or in the absence of such lawful requirements, if in the judgment of the Board of Trustees, then the Board of Trustees, and our Attorney may create a reserve fund from savings accruing at the Exchange or refund the same to SUBSCRIBERS from time to time as they deem best.

Our Attorney shall receive as his full and entire charge 30 per cent of the earned premiums. In consideration of such payment it shall meet and pay all costs and expenses of operating the Exchange, except taxes, fees of insurance or other like departments, attorney fees, court costs, telegrams, cable tolls, the *per diem* and expenses of the Trustees and all other necessary costs and expenses of handling, investigating, adjusting and paying claims and losses.

Disbursements from funds of SUBSCRIBERS shall be by check, signed by our Attorney. Our Attorney shall give such bond as may be required by the Board of Trustees. If at any time, losses should occur in an amount sufficient to require for their payment any part of our contingent liability, herein provided for, we will, upon demand, pay an amount adequate to defray our portion of such losses, subject always to the limitations hereinbefore set forth.

This *contract* and the powers herein conferred is strictly limited to the uses and purposes herein expressed, and to no other use or purpose and is continuous, but may be terminated at the expiration of any contract year by the undersigned or by the Attorney, by either giving to the other sixty days' notice in writing and thereupon our Attorney shall speedily adjust our account and return to us any funds standing to our credit in our deposit premium account.

The intent and purpose of this instrument is to clothe our Attorney with the power necessary to enable us through it to exchange contracts of foreign credit insurance and indemnity with other SUBSCRIBERS.

The personal pronoun used herein shall apply whether the undersigned SUBSCRIBER is a person, firm, co-partnership or corporation.

The undersigned hereby make a deposit of $..... as premium deposit with our Attorney and earned premiums thereafter are subject to monthly adjustment.

*In witness whereof*, We have hereunto set our hand and seal this..... day of.....19...

Approved and accepted: [SEAL] .....

.....

AMERICAN MANUFACTURERS' FOREIGN CREDIT UNDERWRITERS, INC.

By.....*Ass't Secretary.*

.....*Representative.*

## Appendix II

### MASTER POLICY OF FOREIGN CREDIT INSURANCE THE SUBSCRIBERS

AT THE

### AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE

Chicago Ill.

(*Hereinafter called the Exchange*)

THROUGH

### AMERICAN MANUFACTURERS' FOREIGN CREDIT UNDERWRITERS, Inc.

Manager and Attorney-in-Fact

Do hereby severally, and in our respective proportions, agree with..... .....of.....one of said SUBSCRIBERS, hereinafter called the SUBSCRIBER, named and described as such in the *application* and *contract* heretofore executed by him, both of which are agreed and declared to be a part hereof, as follows:

In consideration of the payment of a deposit premium of $..... and/or other premiums named in negotiable Foreign Credit Insurance Certificates issued in accordance with the terms of this policy, and further in consideration of the statements, stipulations and warranties contained in the SUBSCRIBER'S *application* and *contract*, which are, by the acceptance of this policy and negotiable Foreign Credit Insurance Certificate or Certificates issued hereunder, warranted to be true and which are made a part hereof:

To indemnify the SUBSCRIBER in full against loss due to the insolvency (as hereinafter defined) of foreign debtors, which shall occur or result during SUBSCRIBER'S membership at the Exchange, from his granting of credit in connection with his bona fide sales, resales, consignments or shipments of merchandise to those individuals, firms, co-partnerships, corporations or other trade and buying organizations throughout the world who shall be rated and accepted by the American Manufacturers' Foreign Credit Underwriters, Inc., a corporation, manager and attorney-in-fact, and against the insolvency of whom the SUBSCRIBER has taken out insurance at the American Manufacturers' Foreign Credit Insurance Exchange.

1. Policy Period.

The period of this policy shall be for one year and shall begin on the .....day of.....19.., and automatically renew for successive years, in accordance with the SUBSCRIBER'S membership at the Exchange, until cancelled.

2. Premium.

The deposit premium shall be credited to SUBSCRIBER'S premium account at the Exchange. The individual premiums as fixed at the rates determined by the American Manufacturers' Foreign Credit Underwriters, Inc., shall be debited against the SUBSCRIBER'S deposit premium account.

Conditions.

1. The SUBSCRIBER, having complied with the membership requirements as recited in his *application* and *contract* with the Exchange, is entitled to insure his specific credit sales, resales, consignments or shipments of merchandise to buyers in any part of the world, provided that such buyers are rated and accepted by the American Manufacturers' Foreign Credit Underwriters, Inc.

2. All rate quotations are subject to withdrawal by the Exchange and for immediate acceptance by the SUBSCRIBER and no loss is covered by this policy unless the American Manufacturers' Foreign Credit Underwriters, Inc., shall have issued to, or shall have obligated itself in writing to issue to, the SUBSCRIBER, a negotiable Foreign Credit Insurance Certificate in confirmation of its rating and acceptance of a nomination of shipment for the particular debtor covering the specific transaction in connection with which the loss is sustained.

3. Each negotiable Foreign Credit Insurance Certificate issued hereunder shall specify a definite beginning and ending date which shall constitute the period of time during which the SUBSCRIBER is insured against loss in connection with the individual sale, resale, consignment or shipment covered by such Certificate for the premium consideration named therein, (subject to Renewal provision in Conditions 4, 5, and 6), and it is understood and agreed that in addition to the period specified in each original Certificate, the SUBSCRIBER shall be granted a thirty (30) day period of coverage (grace) without cost and each original Certificate issued will so state.

4. The Exchange will not in any event be liable for any loss to a SUBSCRIBER resulting from any trade dispute, disputed account or rejected shipment except a loss arising from insolvency of the debtor. *However*, where a dispute or rejection arises, or when, for any reason, an extension of

time beyond the original terms of sale or period of insurance granted in the original Certificate shall in the judgment of the SUBSCRIBER become necessary or desirable, during the SUBSCRIBER'S membership at the Exchange, the Exchange obligates itself for an additional premium consideration to renew and extend the period or periods of insurance for such time as the SUBSCRIBER may request, subject to Conditions 5 and 6.

5. All negotiable Foreign Credit Insurance Certificates shall be automatically renewed by the American Manufacturers' Foreign Credit Underwriters, Inc., in accordance with the authority given them in SUBSCRIBER'S *contract:* Renewals thereof to be granted for successive renewal periods of one month each and charged to SUBSCRIBER'S premium account at the Exchange. It shall be the SUBSCRIBER'S obligation to notify the Exchange in writing when an insured shipment has been paid or otherwise disposed of in such manner as to obviate the necessity for further continuing the insurance thereon.

6. The Exchange shall be liable only in the event that the debtor becomes insolvent prior to the expiration of the period recited in the negotiable Foreign Credit Insurance Certificate and/or renewals thereof.

7. In the event that a period of three months shall have elapsed after the maturity of the original certificate of insurance and it shall appear to the American Manufacturers' Foreign Credit Underwriters, Inc., that legal steps should be taken to collect the amount due from the debtor, the Exchange may by written notice require the SUBSCRIBER to place the account in the hands of the attorneys for the American Manufacturers' Foreign Credit Underwriters, Inc., or in the hands of an attorney selected by the SUBSCRIBER and approved by the American Manufacturers' Foreign Credit Underwriters, Inc., within thirty (30) days after such notice and upon the failure of the SUBSCRIBER to comply with such request to cancel such insurance or refuse to renew the same, *Provided however*, That if the indebtedness from the debtor to the SUBSCRIBER shall have been assigned, together with such certificate of insurance before the maturity of the original certificate, the Exchange shall not be entitled to cancel or refuse to renew such insurance by reason of the failure or refusal of the SUBSCRIBER or his assignee to comply with such request.

8. A foreign debtor shall be considered insolvent under the terms of this policy when it shall be established that:

(*a*) The aggregate of the property of such debtor at a fair valuation shall not be sufficient in amount to pay his debts and such debtor shall have failed to pay his debts as they matured without legal excuse therefor.

(*b*) A voluntary petition in bankruptcy or insolvency shall have been filed by the debtor according to the laws of the country in which the debtor resides or has his business establishment or the debtor shall have been adjudicated a bankrupt or insolvent.

(*c*) The debtor shall have made an assignment of his assets for the benefit of his creditors.

(*d*) The debtor's stock in trade shall have been sold under a writ of execution.

(*e*) A writ of execution or attachment in the jurisdiction where the principal place of business of the debtor is located shall have been returned unsatisfied.

(*f*) The debtor shall have compromised with a majority in number and amount of his creditors for less than the amount of his indebtedness to them.

(*g*) A receiver for the debtor shall have been appointed and confirmed in a bankruptcy or insolvency proceeding.

(*h*) A certificate shall have been made by the attorneys for the American Manufacturers' Foreign Credit Underwriters, Inc., to the effect that the account is "not collectible at law," which certificate may be based upon evidence submitted either by the member or by the Underwriters.

(*i*) The debtor shall have transferred or sold in bulk his stock in trade without having made due and proper provision for the full settlement of his indebtedness.

(*j*) The debtor shall have absconded.

9. A moratorium declared by any foreign government of the filing of a petition by debtor for suspension of payment or the confirmation or allowance of any such petition shall suspend but not release the liability of the Exchange. There shall be no additional premium charge during the interim of the moratorium or after such petition shall have been filed until the same shall have been allowed or refused, or if allowed, until the period of the suspension shall have expired.

10. Notice of debtor becoming insolvent, in accordance with above definitions of insolvency, must be telegraphed or otherwise immediately communicated by the SUBSCRIBER to the Exchange. This is a condition precedent and any failure by SUBSCRIBER to so notify shall release the Exchange from liability for any loss to SUBSCRIBER due to such insolvency. However, the Exchange shall not be released if the SUBSCRIBER'S failure to notify the Exchange is not in any way due to his negligence.

11. Upon receipt by the SUBSCRIBER, during the period of time wherein

the insured shipment is in course of manufacture or delivery, of notice or information regarding any insolvent act or of any condition or change in the status of the debtor which shall indicate a probability of loss in accordance with the conditions of this policy, the SUBSCRIBER must take the same reasonable and proper steps to prevent said loss as he would in the absence of any insurance, and must telegraph or otherwise immediately communicate to the Exchange said notice or information regarding debtor in order that the American Manufacturers' Foreign Credit Underwriters, Inc., may decide what further action shall be taken by SUBSCRIBER or the Exchange or both, to protect the insured interest; it being understood and agreed that all charges and costs thereby incurred shall be borne by the Exchange in the same proportion that the amount insured bears to the total value of the shipment.

12. If a debtor shall default in the payment of his matured debts, and shall submit a proposition to his creditors showing that his aggregate property at a fair valuation is sufficient in amount to pay his debts in full and requesting that he be granted an extension of time for the payment of such indebtedness, the SUBSCRIBER shall communicate such proposal to the Exchange and shall authorize the representative of the Exchange to act on his behalf in a consideration of the proposal by the creditors, and if a majority in number and amount of the creditors grant an extension to the debtor, the liability of the Exchange on the member's insured indebtedness involved in the extension, shall be suspended but not released during the period of such extension, and there will be no additional premium charge. If the proposition submitted by the debtor which is accepted by the majority in number and amount of the creditors does not provide for the payment in full of his indebtedness, the Exchange will immediately pay to the member the full insured amount of the shipment.

13. In case of payment of any loss under this policy, the Exchange shall be subrogated to the extent of such payment to all the SUBSCRIBER'S rights of recovery and the SUBSCRIBER shall immediately file his claim with the Referee in Bankruptcy, Receiver, Assignee or other proper officer, so as to make said claim a valid one against the assets of the debtor; and unless such claim shall be filed, there shall be no liability hereunder for such claim. It is understood and agreed, however, that any delay in filing such claim with the Referee, Receiver, Assignee or other proper officer, due to distance or abnormal conditions and unforeseen circumstances over which the SUBSCRIBER has no control shall not release the Exchange from liability hereunder, unless the SUBSCRIBER has been negligent. Any negligent act by the SUBSCRIBER, however, which destroys the rights to which the Exchange would otherwise be subrogated, will void the policy.

14. Proof of loss, hereunder, shall be filed by the SUBSCRIBER with the Exchange within ninety (90) days after notice has been received of the insolvency of the debtor, as interpreted under this policy, and any failure of SUBSCRIBER to so notify the Exchange shall release the Exchange from any liability whatsoever. It is understood and agreed, however, that any delay in filing Proof of Loss at the Exchange, due to distance, or abnormal conditions and unforeseen circumstances, over which the SUBSCRIBER has no control shall not release the Exchange from liability hereunder, unless the SUBSCRIBER has been so negligent that the Exchange has lost the rights to which it otherwise would be subrogated.

15. In order to verify the claim, the Exchange shall have the right to examine the SUBSCRIBER'S books of account, shipping documents, and all other papers and documents in connection therewith.

16. The Exchange, within ninety days, shall adjust all losses under the policy, unless such adjustment cannot be completed within such period because of distance or unavoidable circumstances over which the Exchange has no control. All such adjusted losses shall be payable upon the expiration of such period, unless the total claims of loss filed and approved for payment by the Exchange, and arising from a single insolvency, shall exceed $25,000, in which event the Exchange shall have the option of making such payment within nine months after the filing of the proofs of loss.

17. If the debtor shall be indebted to the SUBSCRIBER for an amount in excess of the amount insured, the SUBSCRIBER shall be regarded in the distribution of salvage as a co-insurer to the extent of such surplus.

18. In arriving at the net amount due by the debtor to the SUBSCRIBER at date of insolvency, there shall be deducted from the face amount of the debt, the amount of all discounts to which the debtor would have been entitled had the debt been paid at the date of insolvency, whether by money payments, goods returned or replevined, or other moneys realized, or to be realized on any securities or specific guarantee.

19. If the SUBSCRIBER carries a policy of any other insurer covering concurrently a claim covered by this policy, he shall not recover from the Exchange a larger proportion of any such claim than the amount insured bears to the whole amount of such concurrent insurance.

20. No condition or provision of this policy shall be waived or altered except by endorsement attached hereto signed by duly authorized officers of the American Manufacturers' Foreign Credit Underwriters, Inc., as

Manager and Attorney-in-Fact for the American Manufacturers' Foreign Credit Insurance Exchange.

21. Any misrepresentation, concealment or fraud in the proposal for any insurance or in the presentation of any claim shall render this policy and all outstanding negotiable Foreign Credit Insurance Certificates void, and the premiums shall be forfeited. No suit or action under this policy, on negotiable Foreign Credit Insurance Certificates issued hereunder, shall be maintained against the Exchange unless the SUBSCRIBER shall have fully complied with the conditions of this policy; nor shall any suit be maintained in any event unless it be brought within six (6) months after the proof of claim of the SUBSCRIBER shall have been rejected by the Exchange.

22. In the event of a state of war being declared between the country in which a debtor on an insured shipment resides and any other country, the Exchange will not be responsible in cases of insolvency or bankruptcy caused by the state of war existing between the said nations.

*In witness whereof*, The SUBSCRIBERS at the AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE have severally authorized and caused this policy No..... to be signed for them and in their behalf by the American Manufacturers' Foreign Credit Underwriters, Inc., Attorney-in-Fact of each and every one of them, at Chicago, Ill., this.....day of.....A. D., 19...

AMERICAN MANUFACTURERS' FOREIGN CREDIT UNDERWRITERS, INC.,
*Attorney-in-Fact.*

.....*Asst. Secretary.* .....*Vice-President.*

## Appendix III

### SPECIMEN NOMINATION OF SHIPMENT

OF THE

### AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE

{Acc.....
{Rej.....
{Date.....

To American Manufacturers' Foreign Credit Underwriters, Inc.
Manager and Attorney-in-Fact, for

AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE, Chicago, Illinois

Subject to all the conditions of Master Policy No. 1041, the undersigned, a Subscriber at the American Manufacturers' Foreign Credit Insurance Exchange, nominates for credit insurance, the following specific shipment of merchandise:

Name of Buyer.....A. B. Gonzalez y Cia.....
Address.....Havana, Cuba.....Street and Number....Lamparilla 47...
Gross Amount of Invoice..4987.20.....Date of Invoice..July 25th, 1922...
If partial insurance desired, state amount $.....
Terms of Sale..60 days sight draft D/a..Open account or draft...Draft....
Invoice No.....230756.....Markings....A. B. Gonzalez 1/10 Havana
.....
Insurance is desired for..three..calendar months from..July 25th,..1922..
(Plus one month grace)

Upon acceptance of above for insurance we hereby assign to American Manufacturers' Foreign Credit Underwriters, Inc., all our right, title and interest in and to the above described shipment as it may appear and delegate the American Manufacturers' Foreign Credit Underwriters, Inc., our Attorney-in-Fact to act for and in our name and place on all matters pertaining to the above shipment when in the event and in the judgment of our Attorney-in-Fact, the insured interest herein is disturbed or in jeopardy. Upon request

we agree to furnish said Attorney-in-Fact with duplicate invoice and any other papers relating to this shipment.

(Signed) Consignor-Policy Holder..John Doe & Co.
(%.....) By....R. F. Doe, Treas.,.....
(Date.....)
(Cert. No.....) Address.....Chicago, Ill.....
(Prem.....)
(From.....To.....)

Date....July 20th, 1922....

## Appendix IV

*Original*

### FOREIGN CREDIT INSURANCE CERTIFICATE

ISSUED AT

### AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE

CHICAGO, ILL.

Actual Rate 1⅛%.
Negotiable .....August 1, 1922.....

*This is to certify* that in consideration of ..$56.10....premium paid, and renewal premium to be paid hereafter, the Exchange insured JOHN DOE & Co. for....Four thousand nine hundred eighty-seven 20/100 dollars ($4987.20).. against loss arising by reason of the insolvency of the debtor pursuant to the terms of Master Policy No...1041....covering the following described shipment.....
Name of Debtor.....A. B. GONZALEZ Y CIA.....
Address....Havana, Cuba.....Street and Number....Lamparilla 47.....
Gross Amount of Sale $..4987.20..Terms of Sale..60 days sight draft D/a..
Date of Invoice..July 25, 1922..Insurance attaches..July 25, 1922.....
Insurance expires....Oct. 25, 1922.....(Plus grace).....

In the event that payment of the full amount due from the debtor is not made within the life of this certificate as set forth herein, including grace, this certificate is automatically renewed for such amount as may from time to time remain unpaid upon such expiration dates for additional periods of one calendar month each, to and including the date of the expiration of the Master Policy herein referred to or to the date of the expiration of the Master Policies issued in renewal or extension thereof, unless sooner cancelled by the assured or the holder hereof and this certificate surrendered.

It is hereby understood and agreed that in case of loss such loss is payable on the surrender of this Certificate by the last-named Endorsee and when so paid liability under this Certificate and said Master Policy is discharged.

This Certificate represents and takes the place of the Policy and conveys all the rights of the original policy-holder (for the purpose of collecting any loss or claim) as fully as if the loss were covered by a special policy direct to the endorsee of this Certificate.

The foregoing Certificate shall not be effective unless and until the same has been countersigned by an agent of the Underwriters duly authorized therefor.

AMERICAN MANUFACTURERS' FOREIGN CREDIT INSURANCE EXCHANGE,
(Signed) By American Manufacturers' Foreign Credit Underwriters, Inc.
ALEX. STEINER,
*Secretary.* (Signed) GEO. R. MEYERCORD,
Manager and Attorney-in-Fact *President.*

Countersigned.....

Notice of insolvency of debtor must be telegraphed or otherwise immediately communicated to the Exchange.

FORM FOR ASSIGNMENT ON BACK OF INSURANCE CERTIFICATE

For good and valuable consideration, receipt whereof is hereby acknowledged we hereby set over, transfer, sign and endorse to.....
.....
the within certificate and all claim and demand against the American Manufacturers' Foreign Credit Insurance Exchange arising by reason of the issuance of said certificate, and further agree with said.....
to keep said insurance in force until payment in full of the amount of the shipment described in the within certificate or until a claim therefor as provided in said Policy shall have matured against the American Manufacturers' Foreign Credit Insurance Exchange, and we further agree to duly and punctually pay the premiums as the same shall become due.

## Appendix V

### TRADE INDEMNITY COMPANY, LTD.
OF LONDON

### PROPOSAL
FOR

### CREDIT INSURANCE
(*General Policy*)

Please inform us of the terms on which you are prepared to issue a Policy insuring us against *one half* (or other agreed proportion) of the amount of such net loss as we might sustain by reason of one or more of our customers becoming insolvent during the period of 12 months commencing.....
.....19..

The Amounts to be covered under the Policy shall be in respect only of the invoice value of goods sold and delivered during the above-mentioned period by us to our customers in the ordinary way of the trade or business carried on by us.

We do not anticipate granting a larger credit than £.....to any one customer at any one time. Should we at any time allow a larger credit then the amount in excess of that above-mentioned shall be borne by us.

The majority of the individual credits granted by us do not exceed £..... at any one time.

*Declaration*

1. For the purpose of enabling you to fix the terms on which you are prepared to grant such credit Policy we give the following information respecting our record for the last previous five years:

| Year | Turnover | Aggregate Net Losses | Largest Individual Loss |
|---|---|---|---|
| 19.. | £..... | £..... | £..... |
| 19.. | £..... | £..... | £..... |
| 19.. | £..... | £..... | £..... |
| 19.. | £..... | £..... | £..... |
| 19.. | £..... | £..... | £..... |

2. Our losses during the period subsequent to the last completed year have been £.....on a turnover for the period roughly estimated at £.....

3. We are in the habit of making enquiries regarding prospective customers through.....

4. The usual period and/or terms of credit granted by us to our customers are:

.....

.....

5. The customers whose accounts we desire to include in the insurance are domiciled in the following countries:

.....

6. We consider that either by past experience or by information obtained from reliable sources we have been justified in granting such credits to customers as may have been allowed in the past and we undertake to use every reasonable precaution in granting credit to our customers in the future.

7. The conditions and undertakings of the Policy printed on the back hereof have been carefully read by us and should terms be arranged we are willing to accept such Policy.

This Declaration (which shall be considered to be the basis of the Contract) is made for the sole purpose of enabling you to fix the terms of the Policy, and must be treated in strict confidence.

Signature of Applicant.....
Address.....
.....
Trade.....

Date.....19..

## Appendix VI

### TRADE INDEMNITY COMPANY, LTD.
OF LONDON

### CREDIT INSURANCE POLICY
*(General)*

*Policy of Assurance* granted by the TRADE INDEMNITY COMPANY, LIMITED (hereinafter called "the Company") to M.....
.....
(hereinafter called "the Assured") on the terms, provisos and conditions stated herein.

*Whereas* the Assured is desirous of effecting an insurance with the Company against a proportion (as stated below) of the net ultimate loss which might arise out of transactions with one or more of the Assured's customers in respect of goods sold and delivered in the usual course of the business and for the sole risk and account of the Assured during the undermentioned period.

*Now these presents witness* that in consideration of a premium (minimum £.....) which the Assured has agreed to pay at the rate of..... per cent on the total gross invoice value of goods sold and delivered during the period stated herein the Company agrees to pay the Assured..... o f such sum as the Assured may lose by the insolvency of one or more customers occurring and made known to the Company subsequent to the date of this Policy and on or before the.....19.... (being the date of expiration of this Policy) in respect of a gross credit not exceeding £.....to any one customer duly declared and owing by the customer or customers to the Assured at the date of insolvency.

*The losses* covered by this Policy shall be only such as may arise on the invoice value of goods in respect of which the Assured shall have entered into a contract or contracts of sale during the period commencing..... 19.....and ending.....19.....and which shall have been delivered and debited to customers in the books of the Assured during the said period and prior to the date of insolvency or first act of bankruptcy of the customer less any amounts recovered as dividends or otherwise in respect thereof and the value of any securities which may be held by or on behalf of the Assured and any set-off or counter-claim which may be established against the estate of the insolvent customer.

*When the total amount paid* by the Company under this Policy shall aggregate the sum of £..... (.....pounds) then no further liability shall attach hereto.

*This Policy* shall only apply to the accounts of customers whose head trading office is domiciled in one of the following countries:

.....

.....

*It is hereby* stipulated and agreed that the conditions herein endorsed with the several times and amounts and the declaration and proposal made by the Assured are expressly accepted by both parties as the essence of the contract in the Policy and in case of any material mis-statement in or material omission from the information upon which the terms of the Policy are based or upon which any claim and the settlement thereof are or are to be based or in any case of default by the Assured in performing or observing any of the conditions contained in this Policy the Policy is to be null and void and the premium forfeited.

*By accepting* this Policy the Assured declare that they are unaware of any material circumstances adversely affecting the credit of any customer.

---

CONDITIONS

1. The Assured shall at all times bear at their own risk the balance of credit not covered by this Policy.

2. The Assured shall only grant such credit to customers as has been justified by past experience or by information obtained from reliable sources warranting the amount of credit coming within the scope of this Policy.

3. The aggregate amount of invoices rendered to any and every customer for goods forwarded each month must be declared by the Assured to the Company within the first fourteen days of the month following date of shipment or dispatch of such goods.

4. By the word "insolvent" or "insolvency" wherever mentioned in this Policy it shall be understood that either:

An adjudication in bankruptcy has been made or a composition arrangement in legal form has been agreed to by the creditors generally or a legal assignment has been executed for the benefit of creditors generally or in the case of a limited liability company an order has been made for the same to be liquidated either compulsorily or under supervision or a resolution has been passed in legal form authorising voluntary liquidation provided such resolution is not for the purpose of reconstruction. In the case of debtors domiciled outside the United Kingdom insolvency shall be admitted to exist when in the opinion of the Company such conditions prevail as shall be deemed equivalent to an adjudication in bankruptcy in the case of individuals or firms or to liquidation in the case of incorporated companies.

5. Should any debt or debts owing by any customer declared against this Policy not be admitted to rank against the insolvent estate of such customer then such debt or debts shall be excluded from the scope of this Policy.

6. In the event of a loss arising to the Assured on any individual customer who at the time of insolvency is indebted to the Assured for an amount in excess of the amount attachable to this Policy then any securities, dividends or other sums received or receivable in respect of such debt shall be adjusted pro rata to the respective interests of the Assured and the Company.

7. In the event of the insolvency of any customer the Assured must notify the Company in writing within three days after knowledge thereof forwarding to the Company at the same time a copy of the letter or documents giving notice of such insolvency together with a copy of the account of the customer. The Company shall have the right at any time to examine all letters, documents, books and other matters connected with the transactions between the Assured and the customer and to verify the statements made by the Assured in connection with the proposal for this Policy or any claim thereunder.

8. In the event of the Assured committing an act of bankruptcy, becoming insolvent or transferring the business carried on by the Assured to other parties during the currency hereof then no deliveries of goods made after the date of occurrence of such act of bankruptcy, insolvency or transfer of business shall be admissible hereunder.

9. The adjustment and settlement of any claim hereunder shall take place within seven days from the date on which the net loss shall have been ascertained.

10. Should the Company grant a renewal of the Policy then any debt falling due for payment after the date of expiration hereof or any debt respecting which an extension of the original term of credit has been allowed by the Assured beyond the date of expiration hereof shall rank against the renewal Policy in the event of the customer by whom such debts is owing becoming insolvent after the date of expiration hereof and prior to the date of expiration of the renewal Policy.

11. In the event of any dispute in relation to this Policy or in relation to any claim arising or alleged to have arisen hereunder such dispute shall be referred and determined under the provisions of the Arbitration Act 1889 and any statutory modification thereof or addition thereto and the Assured shall not be entitled to commence or maintain any proceedings at law or in equity until such dispute shall have been so referred and determined and then only for such matter or sum (if any) as shall have been so determined and awarded.

## Appendix VII

### TRADE INDEMNITY COMPANY, LTD.

OF LONDON

### PROPOSAL FOR EXCESS LOSS INSURANCE POLICY

*(Whole Account)*

To the Trade Indemnity Company, Ltd., of London.

We herewith hand you cheque for £.....in payment of premium for an Excess Loss Insurance Policy which we are prepared to accept on the following terms:

1. The above premium of £.....being calculated at.....per cent on an estimated turnover of £.....we agree, should the actual turnover exceed the estimated turnover, to pay you on demand a sum equal to.....per cent on the amount of such excess.

2. We agree to bear at our own risk.....per cent of each and every credit granted and also to bear a "first loss" of.....per cent (minimum £.....) on our gross turnover during the period stated below. In the event of our sustaining a loss in excess of such "first loss" or exceeding the sum of £.....(whichever is the greater) in addition to the amount of loss to be borne by us in respect of each credit granted, you undertake to pay us within one month after our claim has been duly made to you the amount of such excess loss but your liability in no event to exceed the sum of £.....

3. Only such customers whose principal trading offices are established in the following countries shall be admitted under the policy, viz.:

.....

.....

4. Any credit given by us to any customer at any one time in excess of £.....shall be entirely at our own risk.

5. The policy shall only apply to customers as defined therein and who in past transactions have always discharged their indebtedness to us within .....days from the time fixed for payment.

6. Only goods sold, delivered and invoiced between..... 19....and.....19....are to be admitted under the policy.

7. We undertake to make all enquiries respecting our customers as required by the terms of the policy, through at least two of the following sources, viz.: Bankers, Respectable Members of our Trade, Trade Protection Association or.....Mercantile Enquiry Office.....

8. We have carefully read the undertakings and conditions of the policy as printed on the back hereof and hereby accept the terms subject to your being willing to grant such policy on receipt of this proposal.

In making this proposal we hereby confirm the "Statement" already submitted to you and further declare that to the best of our knowledge and belief all customers now standing on our books and with whom we anticipate trading are able to discharge in full their ordinary business engagements.

Signature.....
Address.....
Trade.....

Date.....

## Appendix VIII

---

### TRADE INDEMNITY COMPANY
OF LONDON

### EXCESS-LOSS INSURANCE POLICY

No.....

Insurance Year { Begins.....19.....
Expires.....19.....

*Policy of Assurance* granted by the TRADE INDEMNITY COMPANY, LTD. (hereinafter called "the Company") to.....
M.....
(hereinafter called the Assured) insuring against unforeseen actual losses arising through the insolvency of customers of the Assured in the Assured's business of.....in the following countries .....in which the principal trading offices of such customers are established.

*Whereas* the Assured has made a proposal to the Company desiring to effect an insurance against loss arising by reason of the non-payment of debts through the insolvency of customers of the Assured in excess of an agreed amount of loss to be first borne by the Assured.

*Now these presents witness* that in consideration of a premium (minimum £.....) which the Assured has agreed to pay at the rate of..... per cent on the gross amount of turnover for the period covered by this policy the Company agrees to pay the Assured such sum NOT EXCEEDING £.....as the Assured may lose by the insolvency of customers occurring and made/known to the Assured during the undermentioned period in excess of.....per cent (not being less than £.....) on the amount of the total gross sales and deliveries of goods to customers in the usual course of the Assured's business on transactions made between the day of.....19.....and the.....day of..... 19.....for the Assured's sole risk and account such losses to have actually accrued during the currency of this Policy, and ALSO IN EXCESS of such further loss as this policy provides shall be borne by the Assured.
*Provided:*

(A) That the debts covered by this policy shall be only as follows:

1. In respect of customers with whom the Assured has had dealings during the 12 months preceding the date of the proposal for this policy and who have always discharged their indebtedness within .....days after the date fixed for payment either by the custom of the trade or agreement in writing between the Assured and customer at the time the contract for sale was entered into TO THE EXTENT OF 25 per cent of and in addition to the largest amount of credit given by the Assured to and duly discharged by such customer at any time during the three years preceding the date of this policy.

Should the Assured desire to increase the amount of credit beyond this limit information must be obtained respecting the customer from at least two of the sources stipulated in clause "2" below warranting the increased credit. Such credit is to be estimated as provided also in clause "2" and the information obtained must not be more than three months old at the time such increase of credit is made.

2. In respect of customers with whom dealings have been opened by the Assured during the currency of this policy or to whom the Assured has made no sale of goods during the twelve months preceding the date of the proposal for this policy TO THE EXTENT of the average amount of credit recommended in written or printed reports not more than three months old at the date of accepting the first order or at the date of re-opening (*i. e.*, accepting an order) an old account obtained from at least two of the following sources: (1) Bankers, (2) Respectable Members of the Assured's trade, (3) Trade Protection Association, or (4).....Mercantile Enquiry Office.

(B) That no report adversely affecting the standing of any customer or amount of credit to be granted shall have reached the Assured prior to delivery of goods.

(C) That the Assured shall at all times bear.....per cent of each and every credit granted to customers.

(D) That any credit granted by the Assured to any customer in excess of £.....shall be excluded from the scope of this policy.

(E) That the insolvency of any customers having been ascertained by the Assured the same shall be notified to the Company within fourteen days thereafter on the form to be supplied for that purpose.

*The provisions and conditions* contained herein are expressly accepted by both parties as the essence of the contract in the policy and in the event of

default by the Assured in performing or observing any of the conditions herein contained this policy is to be null and void and the premium forfeited.

---

CONDITIONS

1. The proposal for this insurance shall be the basis of this policy. In case of any material mis-statement, suppression of fact or wilful omission, from the information upon which the terms of the policy are based or upon which the adjustment and settlement of a claim are based or to be based this policy shall be null and void and the premium forfeited.

2. By the word "Insolvent" or "Insolvency" wherever mentioned in this policy it shall be understood that either:

An adjudication in bankruptcy has been made, or A composition arrangement in legal form has been agreed to by the creditors generally, or A legal Assignment has been executed for the benefit of creditors generally or in the case of a Limited Liability Company an order has been made for the same to be liquidated either compulsorily or under supervision or a resolution has been passed in legal form authorising voluntary liquidation provided such resolution is not for the purpose of reconstruction.

3. In the event of a loss arising to the Assured on any individual customer who at the time of insolvency is indebted to the Assured for an amount in excess of the amount attachable to this policy then any sums procured or procurable, received or receivable in respect of such debt shall be adjusted pro rata.

4. If the business of any customer should be reconstructed or converted into a Liability Company both the old and the new style of the business shall for the purpose of this policy constitute one and the same account.

5. In the event of the Assured committing an act of Bankruptcy or becoming insolvent during the currency hereof this policy shall be considered as having expired on the date such Act of Bankruptcy or insolvency occurred and no failures occurring after such date shall be admissible hereunder.

6. The Assured are not entitled to present any claim for settlement until after the expiration of this policy. Any claim under this policy must be notified in writing on a Claim form to be supplied by the Company within sixty days after expiration of this policy with full details on which the same is based (to be verified by statutory declaration if required by the Company) and of any dividend guarantee or security received or to be received directly or indirectly by the Assured or any contra account or claim by which the Assured may benefit in respect of any amount owing by an insolvent customer. The Company shall within one calendar month from the receipt of such notice and details discharge its liability under this policy subject, however, to the

Assured having paid the amount of any additional premium that may be due hereon. The Company shall have the right to examine all books, securities, accounts, information, reports, or any documents pertaining to the proposal for this policy or the adjustment or settlement of any claim thereunder.

7. For the purpose of facilitating the adjustment of any loss alleged to have arisen hereunder:

(*a*) In the event of no dividend having been paid or declared on an insolvent customer's estate and the outcome not be ascertained or ascertainable within one month from the date of expiration of this policy, or, In the event of an amount not exceeding 3/- in the pound having been paid or declared a further dividend being reasonably expected but the amount of such dividend being at the time unascertainable within aforesaid month. *Then* the loss shal be estimated upon the basis that such estate will produce a total of 5/- in the pound.

(*b*) In the event of an amount exceeding 3/-in the pound (but not exceeding 17/6 in the pound) having been paid or declared prior to the expiration of the aforesaid month a further dividend being reasonably expected but being at the time unascertainable. *Then* such further dividend shall be estimated at 2/6 in the pound.

(*c*) As an alternative to either of the above the Assured may elect to await the actual outcome of any estate but in that event no payment shall be made by the Company in respect of any claim under this policy until the administrator of such estate shall have satisfied the Company as to the realization of the entire assets of the estate and the final distribution of the proceeds thereof shall have been made to the creditors.

(*d*) In the event of a composition arrangement having been agreed to by the Assured with an insolvent customer the installments payable under such composition arrangement shall for the purpose of this policy be deemed to have been paid.

8. This Policy shall not admit unless the written consent of the Company be first obtained:

(*a*) Any loss on amounts not admitted to rank against the estate of an insolvent customer. (*b*) Any loss on amounts which have been otherwise partially or wholly insured or guaranteed. (*c*) Any loss on account of customers in whose business the Assured may be in any way financially interested otherwise than by supplying such customer with goods in the ordinary and usual way of business. (*d*) Any loss on amounts owing by customers where the Assured holds or is entitled to hold or benefit by any security for

the payment of such amounts. (*e*) Any loss arising on goods not delivered or interest for delay in payment or for legal or notarial expenses or any other charges which are not customarily debited to a solvent customer's account in respect of goods sold and delivered. (*f*) Any loss which may be incurred on goods delivered to a customer after such customer to the knowledge of the Assured shall have committed an act of bankruptcy or become insolvent.

9. The renewal of this policy shall be optional with the Company but in the event of the Assured desiring to renew application must be made by tendering the amount of premium paid hereon at least seven days before the date of expiry hereof. Any losses occurring after the date of expiration of the policy on goods sold and delivered during its currency shall be deemed to be covered under such renewal (if granted by the Company) but no failure of which notice has been received by the Assured during the currency of this policy shall be brought forward for calculation in the subsequent insurance year.

10. In the event of any dispute in relation to this policy or in relation to any claim arising or alleged to have arisen thereunder such dispute shall be referred and determined under the provisions of the Arbitration Act 1889 and any statutory modification thereof or addition thereto and the Assured shall not be entitled to commence or maintain any proceeding at law or in equity until such dispute shall have been so referred and determined and then only for such matter or sum (if any) as shall have been so determined and awarded. Each party shall pay his or their own cost of the reference and a moiety of the costs of the Award and of the Arbitrator.

Appendix IX

---

## TRADE INDEMNITY COMPANY, LTD.,
OF LONDON

## PROPOSAL
FOR
## CREDIT INSURANCE POLICY

*Open Account (Declaring)*

Please inform us of the terms on which you are prepared to issue a Policy insuring us against.....per cent of such net sum as we may lose by the insolvency of any one or more of the Customers stated in the schedule hereto in respect of a gross credit owing by the Customer not exceeding the amount stated against the name of the Customer.

The loss covered shall be limited to the above stated proportion, and shall be only such as arises on the net invoice value of goods in respect of which we shall have entered into a contract or contracts of sale in the usual course of our business during the period commencing..... 19.....and ending.....19.....and which goods shall have been delivered to the Customer within the said period prior to the date of insolvency or first act of bankruptcy of the Customer.

The Policy shall be exhausted when the invoices rendered and duly declared thereunder shall aggregate the amount of £.....

### Declaration

1. The Customers stated on the schedule hereto have always been punctual in paying accounts, and we have no reason to believe any of them to be in financial difficulties nor are we aware of any circumstances which might influence your acceptance of the risks submitted.

2. We have carefully read the Conditions of the Policy as printed on the back hereof.

This Declaration (which shall be considered to be the basis of the Contract) is made for the sole purpose of enabling you to fix the terms of the Policy, and must be treated in strict confidence.

Signature of Applicant.....
Address.....
Date..... Trade.....

SCHEDULE

| NAME, ADDRESS AND TRADE OF CUSTOMER | GROSS AMOUNT OWING AT ONE TIME | TERMS OF PAYMENT |
|---|---|---|
| | | |

## Appendix X

### TRADE INDEMNITY COMPANY, LTD., of London

### CREDIT INSURANCE POLICY

*Open Account (Declaring)*

*Policy of Insurance* granted by the TRADE INDEMNITY COMPANY, LIMITED (hereinafter called "the Company") to M.....
.....
(hereinafter called "the Assured").

*In consideration of* a premium of £.....the receipt of which is hereby acknowledged the Company agrees to pay to the Assured.....
of such net sum as the Assured may lose by the insolvency of any one or more of the Customers scheduled herein in respect of a gross credit owing by the Customer to the Assured at the date of insolvency not exceeding the amount specified in the schedule against the name of the respective Customer.

*The loss covered by the policy* shall be only such as arises on the net invoice value of goods in respect of which the Assured shall have entered into a contract or contracts of sale in the usual course of the business of the Assured during the period commencing.....19.....and ending.....19.....and delivered to the Customer within the said period prior to the date of insolvency or first act of bankruptcy of the Customer.

*This policy shall be exhausted* when invoices rendered on the terms stated in the schedule and duly declared hereunder shall aggregate the amount of £.....

*The declaration and proposal* made by the Assured are expressly accepted by both parties as the essence of the contract in the Policy and if the Assured shall make any claim knowing the same to be false or fraudulent as regards amount or otherwise this Policy shall become void and all claim thereunder shall be forfeited.

*By accepting this policy* the Assured declare that they are unaware of any circumstance adversely affecting the credit of any Customer scheduled herein.

---

#### Conditions

1. The Assured shall at all times bear at their own risk the balance of the credit not covered by this Policy.

2. The Assured must within seven days after dispatch of goods to Customers herein scheduled duly declare to the Company in order of date the amount of each and every invoice rendered for goods sold and delivered during the period specified and in accordance with the terms of this Policy.

3. The Assured shall have the right of extending the original term of credit for a further period not exceeding three calendar months from the date on which the debt or debts originally matured for payment in consideration whereof the Assured shall pay to the Company proportionate additional premium on the undischarged amount for the extended period, any part of a month being calculated as one month.

4. By the word "insolvency" wherever mentioned in this Policy it shall be understood that either:

An adjudication in bankruptcy has been made, or A composition arrangement in legal form has been agreed to by the creditors generally, or A legal assignment has been executed for the benefit of creditors generally or in the case of a Limited Liability Company an order has been made for the same to be liquidated either compulsorily or under supervision, or A resolution has been passed in legal form authorising voluntary liquidation provided such resolution is not for the purpose of reconstruction. In the case of debtors domiciled outside the United Kingdom insolvency shall be admitted to exist when in the opinion of the Company such conditions prevail as shall be deemed equivalent to an adjudication in bankruptcy in the case of individuals or firms or to liquidation in the case of incorporated companies.

5. The loss covered shall be only such as arises by reason of the insolvency of the Customer on the net invoice value of goods sold and delivered to the Customer for the sole risk and account of the Assured and which shall be admitted to rank against the estate of the insolvent Customer less the amount of the ascertained dividends and the value of any moneys, securities, indemnities, guarantees or any other advantage.

6. In the event of the insolvency of any Customer herein scheduled the Assured must notify the Company in writing within three days after knowledge thereof. The Company shall have the right at any time to examine all letters, documents, books and other matters connected with the transactions between the Assured and the Customer.

7. The adjustment and settlement of claim shall take place within thirty days from the date on which the net loss shall have been ascertained.

8. Any dispute in relation to this Policy or to any claim alleged to have arisen thereunder shall be referred and determined under the provisions of the Arbitration Act 1889 and any statutory modifications thereof or additions thereto. Each party shall pay his or their own cost of the reference and a moiety of the cost of the Award and of the Arbitrator.

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